INSOL INTERNATIONAL

FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

Module 8A Guidance Text

Australia

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1. INTRODUCTION TO INTERNATIONAL INSOLVENCY LAW IN AUSTRALIA

Welcome to **Module 8A**, dealing with the insolvency system of **Australia**. This Module is one of the elective module choices for the Foundation Certificate. The purpose of this guidance text is to provide:

- a general overview, including the background and history, of Australia's insolvency laws;
- a relatively detailed overview of Australia's insolvency system, dealing with both corporate and consumer insolvency; and
- a relatively detailed overview of the rules relating to international insolvencies and how they are dealt with in the context of Australia.

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please note that the formal assessment for this module must be submitted by **11 pm (23:00) BST (GMT +1) on 31 July 2023**. Please consult the web pages for the Foundation Certificate in International Insolvency Law for both the assessment and the instructions for submitting the assessment. Please note that no extensions for the submission of assessments beyond 31 July 2023 will be considered.

For general guidance on what is expected of you in the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law on the INSOL International website.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of insolvency law in Australia:

- the background and historical development of Australian insolvency law;
- the various pieces of primary and secondary legislation governing Australian insolvency law;
- the operation of the primary legislation in regard to liquidation and corporate rescue;
- the operation of the primary and other legislation in regard to corporate debtors;

- the rules of international insolvency law as they apply in Australia;
- the rules relating to the recognition of foreign judgments in Australia.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of Australian insolvency law; and
- be able to answer questions based on a set of facts relating to Australian insolvency law.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in **Appendix A**.

3. AN INTRODUCTION TO AUSTRALIA

Australia is a nation state located in the Asia Pacific region with a population of 25 million. Australia became an independent state in 1901 upon the federation of six British colonies (New South Wales, Queensland, South Australia, Tasmania (external to mainland Australia), Victoria and Western Australia) and two mainland territories (the Australian Capital Territory and the Northern Territory). The federation is formally known as the Commonwealth of Australia. Australia remains a member of the Commonwealth of Nations. It also retains Queen Elizabeth II as its head of state.

Politically, Australia is a parliamentary democracy with democratically elected parliaments and governments at state level and at the national level. The Parliament of Australia, also known as the Commonwealth Parliament or Federal Parliament, is the legislative branch of the government of Australia. It is bicameral and has been influenced both by the British Westminster system and United States federalism.

Australia is an open market with minimal import restrictions. In the last 50 years, it has become an internationally competitive, advanced market economy. This is due to economic reforms implemented in the 1980s, its location in the rapidly growing AsiaPacific region, and the export of its natural resources. However, in 2018, a sharp fall in global prices of Australia's export commodities has reduced the rate of growth.

In 2019, Australia’s GDP was USD 1.40 trillion, making it the 13th-largest national economy by nominal GDP.[1] Australia is a significant exporter of natural resources, energy, food and education. Its top six exports are iron ore, coal, natural gas, education-related travel services,

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[1] World Bank, “GDP Ranking”, *World Bank Open Data*, available at https://datacatalog.worldbank.org/dataset/gdp-ranking, accessed 26 April 2021.

tourism and gold.[2] Australia's abundant and diverse natural resources attract high levels of foreign investment.[3]

Australia's top three trading partners are China, Japan and the United States.

4. LEGAL SYSTEM AND INSTITUTIONAL FRAMEWORK

4.1 Legal System

Australia has a common law legal system inherited from England. As in England, the two main sources of law in Australia are statute and common law. Where an inconsistency arises between statute and common law, the statute will prevail.

Statute is any legislation, called "Acts", passed by the Federal Parliament or by a Parliament of one of the States or Territories. Under the Australian Constitution, the States have the power to legislate on all subjects. The Federal Parliament is given the power to legislate in relation to a limited number of specific subjects.[4] The specific subjects over which the Commonwealth has power to legislate include bankruptcy and corporations.[5]

The common law is the law as set out in past judgments of Australian courts. Past judgments of Australian higher courts are binding on Australian lower courts. Also, past judgments of higher courts in England are frequently referred to in Australian judgments. They are considered highly persuasive, but they are not binding on Australian courts. Australian judgments also occasionally refer, as persuasive, to judgments of other courts in common law countries, such as New Zealand, Canada and the United States.

Culturally, the Australian legal system is similar to other common law systems. Its court systems at federal, state and territory levels are well-established. They are perceived to be fully independent and unbiased. The courts and judges are broadly respected in the community. There is also a well-established independent legal profession, including lawyers specialising in insolvency and cross-border insolvency. Judges are drawn from the most senior members of the legal profession.

4.2 The development of insolvency law in Australia

Before federation in 1901, each of the separate colonies had adopted its own insolvency laws based on either the 1883 or the 1869 English Bankruptcy Act.

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2 Australian Government, Department of Foreign Affairs and Trade, *Trade and Investment at a Glance 2020*, available at https://www.dfat.gov.au/sites/default/files/trade-investment-glance-2020.pdf, accessed 26 April 2021.

3 Australian Government, Productivity Commission, *Foreign Investment in Australia* (Research Paper, June 2020), available at https://www.pc.gov.au/research/completed/foreign-investment/foreign-investment.pdf at page 27, accessed 26 April 2021.

4 Commonwealth of Australia Constitution Act, s 51.

5 *Idem*, s 51(xvii) and (xx) respectively.

On federation, the Australian Constitution gave the Commonwealth the power to legislate on the subject of "bankruptcy and insolvency" and on the subject of "corporations". The first national bankruptcy legislation (dealing only with individuals) was passed in 1924.

The current Bankruptcy Act was passed in 1966. In 1976, the Federal Court of Australia was created and was given exclusive jurisdiction over bankruptcy matters. In 2000, the Federal Circuit Court was created as a new court below the Federal Court of Australia. Most bankruptcy matters are now heard by the Federal Circuit Court.

Even after federation in 1901 and despite the grant of legislative powers to the Commonwealth, the insolvency of corporations continued to be legislated at state level, because the High Court of Australia in 1909 had narrowly construed the Commonwealth's "corporations" power. Each State had its own Companies Act.

In the 1960s, each of the States enacted a Companies Act based on a uniform model.

In 1988, the Australian Law Reform Commission produced its first major review of Australian bankruptcy and corporate insolvency law (known as the "Harmer Report").[6] The recommendations in the Harmer Report remain the foundation for the present legislative regimes. In particular, the Harmer Report recommended the introduction of a voluntary administration regime as a business rescue tool, which could then lead to a deed of company arrangement or to a liquidation, depending on whether the business could be rescued. The voluntary administration regime was introduced into the uniform Companies Acts in 1992. The voluntary administration concept has since been adopted in New Zealand and is the model that was looked to in the creation of the UK administration regime.

Finally, in 2001, the States referred the necessary legislative powers to the Commonwealth so that the Commonwealth could pass the first national legislation regulating companies and their insolvency procedures, being the Corporations Act 2001.

Australia has retained the English distinction in terminology between "bankruptcy" for individuals and "liquidation" (also called "winding up") for companies. In Australia, as in the UK, the term "insolvency" normally refers to corporate insolvency and not to personal bankruptcy. Despite recent calls for unification of the bankruptcy and corporate insolvency legislation, they remain separate with no plans for their unification.

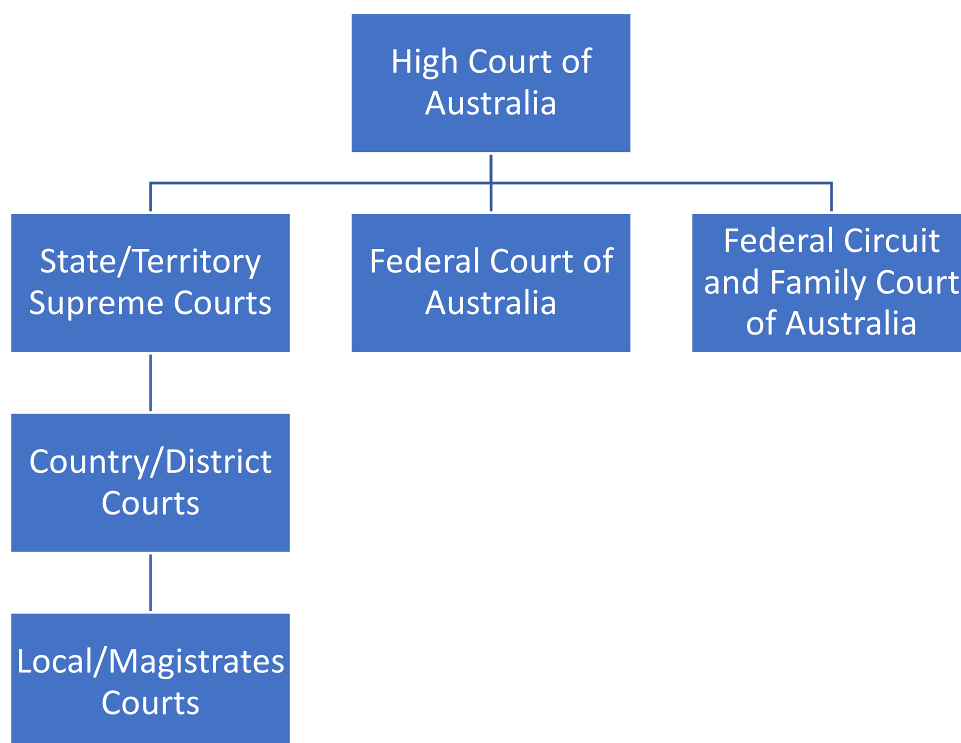
4.3 Institutional framework

4.3.1 Court system

The Australian court system consists of both state and federal courts. The apex court of both the state and federal courts is the High Court of Australia. Decisions of the High Court take

[6] Australian Law Reform Commission, Report No 45, *General Insolvency Inquiry* (1988), available at http://www.austlii.edu.au/au/other/lawreform/ALRC/1988/45.html, accessed 1 December 2018.

precedence over all other decisions and are not appealable. The court structure in Australia is as set out in the below diagram.



The Australian court system generally operates effectively and efficiently to enforce debtor and creditor rights.[7] According to the World Bank's *Doing Business 2020 Economy Profile: Australia*, Australia ranks 6th best in the world for ease of enforcing contracts through court proceedings.[8]

According to the World Bank, Australia ranks 20th best in the world in terms of the time, cost and outcome of insolvency proceedings involving Australian legal entities.[9] The World Bank methodology found that the time for recovery of debts in insolvency is one year, recovery is 82.7 cents on the dollar and the cost of conducting insolvency proceedings is 8% of the insolvent estate (each of these figures is better than the OECD high income averages of 1.7 years, 70.2 cents in the dollar and 9.3% respectively).[10]

4.3.2 Enforcement system for creditor rights

Australia is considered a creditor-friendly system both generally and in its insolvency processes.

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7 Michael Murray and Jason Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (Thomson Reuters, 10th ed, 2018) at 31.

8 World Bank, *Doing Business 2020 Economy Profile: Australia*, available at https://openknowledge.worldbank.org/bitstream/handle/10986/33007/Doing-Business-2020-Comparing-Business-Regulation-in-190-Economies-Economy-Profile-of-Australia.pdf?sequence=1&isAllowed=y, accessed 26 April 2021 at page 52.

9 *Idem* at pages 57-58.

10 *Idem* at page 58.

4.3.2.1 Unsecured creditors

Unsecured creditors can bring court proceedings to enforce debts. Smaller claims will be brought in the Local or Magistrates Courts, where they will be dealt with fairly swiftly and relatively cheaply. Medium size claims will be brought in the Country or District Court. Larger claims (AUD 1 million and over in most states) must be brought in the Supreme Court of the State or Territory. Claims can be brought in the Federal Circuit Court or the Federal Court if they also include statutory claims under Federal legislation, or if they relate to bankruptcy or corporate insolvency.

Unsecured creditors can issue a specific notice provided for under the Bankruptcy Act and the Corporations Act requiring the individual or company to pay the debt. If the debt is not paid within 21 days after the issue of the notice, the unsecured creditor may apply for the individual to be made bankrupt or for the company to be wound up in insolvency. Failure to comply with this type of demand is an act of bankruptcy by an individual and it creates a presumption of insolvency against an individual or a company. Although the courts have said that this procedure should not be used as a debt collection tool against solvent individuals or companies, it is a highly effective one.

4.3.2.2 Secured creditors

Secured creditors are well protected under Australian law. On World Bank measures, Australia scores an 11 (on a scale of 0-12) for protection of the rights of secured creditors.[11] The protection of security interests is discussed in paragraph 5 below.

4.3.2.3 Creditor rights in insolvency

Australia's insolvency regime, for both personal and corporate debtors, is regarded as being creditor-friendly. The primary focus is on the protection of creditors' rights to the exclusion of management and shareholders, notwithstanding the consequent adverse impact on corporate and business rescue which may be in the interests of employees, small suppliers and other corporate stakeholders.

Of particular note:

- secured creditors are entitled to enforce their rights during the bankruptcy process for an insolvent individual (see paragraph 6.2.3.4 below) and the liquidation process for an insolvent company (see paragraph 6.3.7 below);

- despite one of the stated aims of voluntary administration (as the primary formal corporate rescue process in Australia) being to maximise the chance of an insolvent company, or as much as possible of its business, continuing in existence under the terms of a deed of company arrangement (DOCA),[12] an alternative aim of voluntary administration is to simply

[11] *Idem* at pages 30-31.
[12] Corporations Act, s 435A(a).

enable a maximum return to be achieved for distribution to creditors (see paragraph 6.5.2.1 below);

- major creditors with security over the whole or substantially the whole of a company's property remain entitled, subject to compliance with certain time restrictions, to appoint a receiver over the top of a voluntary administrator (see paragraph 6.5.2.4 below);

- non-major secured creditors, as well as owners and lessors with enforcement rights, can continue with enforcement action which has been commenced prior to the appointment of a voluntary administrator or which relates to perishable property, or otherwise with the consent of the court (see paragraph 6.5.2.4 below);

- Australia has broad insolvent trading liability, which allows a liquidator to recover substantial sums from directors (usually via a directors' and officers' insurance policy) where the directors have allowed a company to incur debts whilst insolvent;

- Australia's voidable transaction regime, particularly in corporate liquidation, allows transactions to be clawed back for the benefit of creditors over a substantial period of years and without having to prove improper conduct such as an intention to defeat creditors.

Nevertheless, the corporate voluntary administration regime and some relatively recent reforms to the corporate insolvency process in Australia are designed to encourage a stronger corporate and business rescue culture and promote a move away from the existing dominance of creditors' rights. Specifically:

- the voluntary administration regime has as its primary goal the maximisation of the chance of an insolvent company, or as much as possible of its business, continuing in existence under the terms of a DOCA;[13]

- subject to certain exclusions, as of 1 July 2018, creditors are prevented from enforcing *ipso facto* contractual rights contingent only on a company's insolvency or entry into an external administration (see paragraph 6.5.2.5 below).[14] The personal insolvency regime takes an even stricter approach, with the Bankruptcy Act rendering *ipso facto* clauses void outright when a person becomes bankrupt (see paragraph 6.2.3.7 below); and

- as of September 2017, company directors can take advantage of a "safe harbour" from insolvent trading liability, so that they can continue to allow a company to incur debts with a view to implementing an informal restructuring attempt under the supervision of an appointed expert restructuring expert (see paragraphs 6.3.15 and 6.5.4 below).[15]

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[13] *Idem,* s 435A(a).

[14] The *ipso facto* moratorium commenced operation on 1 July 2018, following the passage of the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017 (Cth).

[15] The safe harbour commenced operation on 19 September 2017 and was also introduced by the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017 (Cth).

4.3.3 Insolvency regulation

4.3.3.1 Bankruptcy matters

The regulatory body for bankruptcy matters is the Australian Financial Services Authority (AFSA). AFSA has the following roles:

- it acts as trustee in most bankruptcies and personal insolvency agreements (as the Official Trustee in Bankruptcy), particularly in low-asset or assetless bankruptcies;
- it maintains the register of all personal insolvency proceedings in Australia;
- it conducts registration of personal insolvency practitioners as "registered trustees";
- it regulates personal insolvency practitioners; and
- it investigates alleged Bankruptcy Act offences.

AFSA also manages Australia's Personal Property Securities Register (discussed in paragraph 5.2 below).

4.3.3.2 Corporate insolvency

The regulatory body for corporate insolvency is the Australian Security and Investments Commission (ASIC). ASIC provides information regarding insolvent companies, principally through its company register which is accessible online, as well as through the ASIC Insolvency Notices website where advertisements and announcements regarding companies under external administration must be posted. ASIC also conducts registration of, and regulates the conduct of, insolvency professionals, as "registered liquidators". ASIC also has the power to apply to the court to wind up an insolvent company and it has specific powers to seek certain orders from the court in relation to insolvent companies.

Regulation of insolvency professionals is largely self-managed through the Australian Restructuring Insolvency and Turnaround Association (ARITA). In addition to this self-regulation, there are statutory provisions within the Corporations Act that establish the minimum duties and standards expected of insolvency practitioners.

There are also a number of professional bodies within the field of corporate insolvency. While the largest of these is ARITA, other such bodies include the Association of Independent Insolvency Practitioners (AIIP), the Turnaround Management Association (TMA) and the Law Council of Australia's Insolvency and Restructuring Law Committee. These organisations provide support to insolvency practitioners and offer further guidance regarding the expected professional standards.

The courts also have powers to supervise, direct, and sanction insolvency practitioners when questions come before the court regarding the performance of their duties. Many of the court's

powers are set out in the Bankruptcy Act and the Corporations Act. In addition to these powers, the court has an inherent power to supervise the conduct of court-appointed bankruptcy trustees, court-appointed liquidators and court-appointed receivers, as they are all officers of the court with paramount legal and ethical duties to the court.

Self-Assessment Exercise 1

Question 1

For each of personal bankruptcy and corporate insolvency, what is:

- the governing legislation;
- the relevant regulatory body; and
- the courts in which proceedings may be brought?

Question 2

In terms of insolvency law, is Australia considered to be a debtor-friendly or a creditor-friendly jurisdiction? Why?

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5. SECURITY

Security interests may be granted over land or over any personal property (that is, property other than land), both tangible and intangible. Security interests should be registered either in the relevant state land registry (for mortgages) or on the national Personal Property Securities Register (PPSR) (for all other security interests). Each registry is accessible online. Failure to register a security interest will result in other security interests taking priority over the unregistered interest and may result in loss of a security interest on the commencement of an external administration. Between registered security interests, those registered first take priority over later-registered security interests. Security interests continue to exist in the proceeds of sale of secured assets.

5.1 Security over land

Most land in Australia is registered under a system known as the Torrens system. Each state and territory operates its own register for land located in its jurisdiction. The register records details of the land and any registered interests in that land (for example, mortgages, leases and easements).

A fundamental principle of the Torrens system is that the register is paramount. This means that the title of a registered mortgagee of Torrens land is not affected by any defects in title or unregistered interests. This is known as "indefeasibility of title". There are some limited

exceptions to indefeasibility, including prior registered interests, fraud, easements and surveying errors, among others.

The most common form of security granted over real estate is a registered mortgage. A Torrens title mortgage operates as a statutory charge on the interest in the land, rather than as a transfer of the land.

Where a security interest is granted over all of the assets of the debtor, including both land and personal property, the security interest will need to be registered on both the relevant land register and on the Personal Property Securities Register.

5.2 Security over personal property

Australia has adopted a national regime in the Personal Property Securities Act 2009 (Cth) (PPSA) pursuant to which all personal property security interests are to be registered on the Personal Property Securities Register (PPSR).[16] The legislation is based on the New Zealand and Canadian models.

Security interests over personal property may be "non-circulating" (formerly known as fixed charges), meaning that they are granted over a specific asset, or "circulating" meaning that they exist over any property of a certain type that is owned by the security grantor at any point in time after the grant of the security, and the secured party has given the grantor authority to transfer the property in the ordinary course of the grantor's business free of the security interest (formerly known as a floating charge).[17] A circulating security interest will normally be over property that naturally fluctuates as part of the conduct of the business, such as inventory, book debts or cash. It is also possible under the PPSA to create a non-circulating security interest over such property, although the question of when such an interest will be validly created is currently the subject of litigation before the courts.

Another type of security interest is the "purchase monies security interest" or PMSI, which is a security interest that secures the obligation of the grantor to pay the purchase price of the secured assets, for example, "retention of title" clauses create a PMSI. PMSIs are significant as they afford their holder a form of super-priority, which gives that secured party priority over even a prior-perfected secured party.

A further security interest that requires registration on the PPSR is a PPS Lease, being a lease of goods for more than one year or for an indefinite term.

Once a security interest has been granted, it should also be "perfected". Perfection is not a concept previously used in Australian security law. It refers to the process whereby a security interest acquires the optimal protection available under the PPSA. There are three main ways in which a security interest can be perfected: i) by possession; ii) by control; or iii) by registration. Registration is the most common method of perfection.

[16] See Personal Property Securities Act 2009 (Cth).
[17] *Idem*, ss 339, 340.

Security interests granted by Australian residents or companies should be registered, regardless of where in the world the secured property is located. Also, security interests granted over personal property located in Australia, even where granted by a person resident overseas or by a foreign company, should also be registered. This is a departure from the old rules prior to the introduction of the PPSA.

5.3 Loss of unregistered or late-registered personal property security on insolvency

It is important for lenders, equipment lessors and providers of goods on consigment to have a good understanding of the registration requirements for the PPSR, as failure to register or otherwise perfect a security interest can cause the loss of the security on insolvency.

Any unperfected security interest will automatically vest in the grantor (usually the debtor) immediately prior to the commencement of a bankruptcy, voluntary administration or liquidation of the grantor.[18] Perfection, usually by registration, is therefore critical to the protection of a secured creditors' rights in insolvency.

Security interests over personal property of a company will also vest in the grantor company immediately prior to the commencement of a voluntary administration or liquidation (external administration) of the grantor, unless:[19]

(a) the security interest was registered at least six months before the commencement of the external administration; or

(b) if created during the six months prior to external administration, the security interest was registered within 20 days of it having been created and more than 20 days before the commencement of the external administration; or

(c) for any security interest that came into force under the law of a foreign jurisdiction but first became enforceable in Australia during the six months prior to external administration, the security interest was registered within 56 days of it having become enforceable in Australia and more than 56 days before the commencement of the external administration; or

(d) the court extends the time for registration, on an application by the secured party showing sufficient cause.[20]

5.4 Treatment of secured creditors in insolvency

Secured creditors are paid first (that is, before tax claims and employee claims) when a debtor defaults outside an insolvency procedure. Secured creditors holding non-circulating security interests are paid first (that is, before tax claims and employee claims) when a company is

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[18] *Idem*, s 267.
[19] Corporations Act, s 588FL.
[20] *Idem*, s 588FM.

liquidated or in a bankruptcy. Secured creditors holding circulating security interests over company assets are paid after employee claims but before tax and other claims.

Secured creditors that do not hold security over all or substantially all of the debtor's assets are subject to an automatic stay on enforcement when a corporate debtor enters voluntary administration (which can be a precursor to a reorganisation). However, secured creditors are not subject to any stay once a company enters liquidation or if a person is made bankrupt.

Parties can contractually agree that a secured creditor will have a right to appoint a receiver over the debtor's property if the debtor defaults in repayment of the debt.

Self-Assessment Exercise 2

A foreign company takes security governed by Australian law over the fleet of trucks of an Australian trucking company. The foreign company waits 30 days before registering its security interest on the PPSR. Five months after the security interest was granted, the company is placed into voluntary administration. What happens to the security interest over the trucks?

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

6. INSOLVENCY SYSTEM

6.1 General

6.1.1 Relevant legislation

As already discussed, the Australian bankruptcy and insolvency regime is spread across two pieces of legislation:

- for personal insolvency, the Bankruptcy Act 1966 (Cth) (Bankruptcy Act);[21] and
- for corporate insolvency, the Corporations Act 2001 (Cth) (Corporations Act).[22]

The Insolvency Law Reform Act 2016 (Cth) (ILRA) made a number of significant changes to insolvency law and practice in Australia, with one of the primary aims being to achieve greater harmonisation between the processes for personal and corporate insolvency. In particular:

[21] Including Sch 2 of that Act being the Insolvency Practice Schedule (Bankruptcy) (IPSB), as supported by the Bankruptcy Regulations 1996 (Cth) (Bankruptcy Regulations) and the Insolvency Practice Rules (Bankruptcy) 2016 (Cth) (IPRB).

[22] Including Schedule 2 of that Act being the Insolvency Practice Schedule (Corporations) (Cth) (IPSC), as supported by the Corporations Regulations 2001 (Cth) (Corporations Regulations) and the Insolvency Practice Rules (Corporations) 2016 (Cth) (IPRC).

- the registration process for corporate insolvency practitioners is now broadly similar to the registration process for trustees in bankruptcy, with similar professional standards applying to both personal and corporate insolvency practitioners;

- there are common disciplinary and deregistration procedures for personal and corporate insolvency practitioners, with jurisdiction exercised by a committee comprising regulatory and ministerial representatives as well as nominated registered liquidators or trustees (removing the previous disciplinary jurisdiction exercised over liquidators by the Companies Auditors and Liquidators Disciplinary Board); and

- the oversight role of the courts and creditors has been made co-extensive during both personal and corporate insolvency (discussed further in paragraph 6.3 below).

However, despite the reforms made by the ILRA, there continue to be other important substantive differences between the personal and corporate insolvency regimes, as well as different regulatory and policy approaches as a result of the split between:

- for personal insolvency, regulatory and policy oversight being maintained by the Australian Financial Security Authority (AFSA) and the Attorney General's Department respectively; and

- for corporate insolvency, regulatory and policy oversight being maintained by the Australian Securities and Investments Commission (ASIC) and the Treasury Department respectively.

6.1.2 Management of insolvency proceedings

In Australia, the various forms of personal and corporate insolvency administration largely take place privately, with minimal court involvement.

While court involvement is required to obtain a sequestration order for an insolvent individual in the context of involuntary bankruptcy or a compulsory winding up order for an insolvent company (see paragraphs 6.2.3.2 and 6.3.5 below), after that time the courts retain only a general supervisory role during the bankruptcy and liquidation process.

In contrast to the active role played by the Bankruptcy Court during the Chapter 11 reorganisation process in the United States, Australian courts take a "back seat role" during voluntary administration and the comparable "rescue" procedures for personal insolvency (personal insolvency agreements and debt agreements).

For those forms of insolvency process, the insolvency practitioner is appointed privately rather than by way of a court application and the insolvency practitioner can conduct the administration without the involvement of the courts. A trustee or administrator can apply to the court for directions about particular dealings with assets or creditors and, equally, creditors and other stakeholders may apply to the court for relief in relation to a particular decision or action taken

or proposed to be taken by a trustee or administrator or to otherwise enforce specific rights reserved to them under the legislative regimes.

Likewise, in Australia, receivers are generally appointed privately by a secured creditor exercising rights under a security interest over a company's assets. While it is possible for a court to appoint a receiver under inherent or statutory powers, that is relatively rare in practice and does not arise exclusively in the corporate insolvency space.

Very few of the Australian insolvency processes are debtor-in-possession processes. For a company in liquidation, voluntary administration or receivership, although directors remain formally in office they cannot exercise their powers. It is instead the liquidator, voluntary administrator or receivers that can exercise the directors' former powers (see paragraphs 6.3.6, 6.4.3 and 6.5.2.3 below). The only two debtor-in-possession processes in Australia are schemes of arrangement (which do not always involve insolvency), and small company restructurings. For the latter, although the process is debtor-in-possession in the sense that the directors can continue to exercise their powers, the company must nonetheless engage a qualified insolvency practitioner as an advisor.

In a personal insolvency agreement or a debt agreement for an individual debtor, the debtor plays a key role in negotiating the terms of the agreement with creditors before a trustee or administrator is then appointed to administer the agreement (see paragraphs 6.2.4.1 to 6.2.4.2 below).

An Australian creditors' scheme of arrangement, which is very similar to the English scheme of arrangement, is very much a court-driven process, necessitating a minimum of two court hearings before the scheme can become effective (see paragraph 6.5.3 below). The company's directors play an active role in negotiating the terms of the scheme with creditors and subsequently remain in office pending the implementation of the scheme, subject to any terms of the scheme document to the contrary.

As a result of the ILRA, there is now a common process for creditor oversight during personal and corporate insolvency, which is intended to ensure that insolvency practitioners remain accountable and responsible during the insolvency administration. Of particular note:

- trustees of the estates of regulated debtors (persons who are bankrupt or whose property is subject to a personal insolvency agreement) and liquidators, but not any other type of insolvency practitioner, have an obligation to convene a meeting of creditors at any time during the insolvency administration if reasonably directed to do so by the creditors. Creditors representing 25% (or sometimes less) of the value of creditors can require a meeting;[23]

[23] IPSB, r 75-15; IPSC, r 75-15.

- creditors may request that an external administrator[24] provide information, a report or a document to creditors[25] and the request must generally be complied with unless it is unreasonable or the material irrelevant;[26] and

- a majority of creditors may give an external administrator directions,[27] to which the external administrator must "have regard", but they are not required to comply with the directions if reasons for not doing so are provided to creditors.[28]

6.2 Personal bankruptcy

6.2.1 Application of regime

Australian bankruptcy law applies to persons who, at the time they commit an "act of bankruptcy", are personally present in Australia, or ordinarily reside in, have a house or place of business, or carried on business in Australia. The bankruptcy law then applies to all of the person's assets worldwide.

The regime applies only to individuals[29] and only to those who are insolvent. The Bankruptcy Act provides that:

- a person is solvent if, and only if, the person is able to pay all of their debts as and when they become due and payable; and

- a person who is not solvent is insolvent.[30]

The test for insolvency is therefore a "cash flow test" rather than a balance sheet test, with a focus on liquidity rather than a person's net asset position.[31] Nevertheless, the courts in Australia distinguish between a temporary lack of liquidity and a terminal lack of liquidity, so that money which a person can obtain in selling, or borrowing against the security of, their assets within a relatively short time may be taken into account in assessing whether the person is solvent.[32]

There is no obligation on persons to enter into formal insolvency proceedings of their own volition if they become insolvent.

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[24] An "external administrator" is defined in IPS (Corporations) s 5-20 as a liquidator, provisional liquidator, voluntary administrator or deed administrator (with "external administration" defined in s 5-15 as liquidation, provisional liquidation, voluntary administration or a deed of company arrangement). Receivers and scheme administrators are not "external administrators".

[25] IPSB, rr 70-40(1), 70-45(1), 80-40(1); IPSC, rr 70-40(1), 70-45(1), 80-40(1).

[26] *Idem*, rr 70-40(2), 70-45(2), 80-40(2); IPSC, rr 70-40(2), 70-45(2), 80-40(2).

[27] *Idem*, rr 80-35(1)(b), 85-5(1); IPSC, rr 80-35(1)(b), 85-5(1).

[28] *Idem*, rr 85-5(2), 85-5(3); IPSC, rr 85-5(2), 85-5(3).

[29] Bankruptcy Act, s 7.

[30] *Idem*, ss 5(2), 5(3).

[31] *Crema Pty Ltd v Land Mark Property Developments Pty Ltd* (2006) 58 ACSR 631, 652.

[32] *Sandell v Porter* (1966) 115 CLR 666, 670.

6.2.2 *Types of bankruptcy and personal insolvency proceedings*

When a debtor becomes insolvent, there are bankruptcy and non-bankruptcy alternatives for dealing with the debtor's assets.

In terms of the bankruptcy alternatives, a debtor may become bankrupt either:

- voluntarily, by presenting a debtor's petition to the "Official Receiver" (which function is performed by AFSA); or

- involuntarily, upon the court making a sequestration order following the presentation of a creditor's petition to the court.

In terms of the formal non-bankruptcy alternatives, a debtor may secure the discharge of their debts outside of bankruptcy by entering into, with the debtor's creditors:[33]

- a personal insolvency agreement under Part X of the Bankruptcy Act; or

- a debt agreement under Part IX of the Bankruptcy Act.

All three formal alternatives result in a stay or moratorium on unsecured creditor action outside of the formal proceeding.

In the financial year 2020/2021, the numbers of each type of formal personal insolvency process were:[34]

- bankruptcies: 6,792

- personal insolvency agreements: 89

- debt agreements: 3,731

Apart from the formal non-bankruptcy alternatives, it is also open to a debtor to seek to enter into a private informal arrangement with their creditors providing for a staged pay-out of debts in return for creditors agreeing to refrain from immediate enforcement action. However, unlike formal non-bankruptcy alternatives, an informal arrangement is not binding on dissenting creditors and in an Australian creditor culture marked by individual enforcement rather than collectivism, a private arrangement depending on the agreement of multiple creditors with competing interests is difficult to achieve in practice.

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[33] For a simple comparison of bankruptcy, personal insolvency agreements and debt agreements, see AFSA, *Compare the formal options*, at https://www.afsa.gov.au/insolvency/i-cant-pay-my-debts/compare-formal-options, accessed 10 December 2018.

[34] AFSA, *Provisional annual personal insolvency statistics 2020-21*, available at https://www.afsa.gov.au/statistics/annual-statistics, accessed 1 August 2022.

6.2.3 *Bankruptcy*

6.2.3.1 Voluntary bankruptcy – commencement

In Australia, the vast majority of bankruptcies proceed as voluntary bankruptcies.

The Bankruptcy Act also provides for the presentation of a joint debtors' petition by partners or other joint debtors such as married persons.[35]

Before filing a final debtor's petition, a debtor may elect to lodge with the Official Receiver an initial declaration of an intention to present a debtor's petition.[36] If accepted, a 21-day moratorium is invoked which prevents unsecured creditors (but not secured creditors) from enforcing their claims against the debtor or the debtor's property, although it is still possible for unsecured creditors to initiate involuntary bankruptcy by filing a creditor's petition (discussed in paragraph 6.2.3.2 below).[37]

In filing a debtor's petition, a debtor is required to lodge a statement of affairs listing all of the debtor's assets and liabilities and establishing their connection with Australia.[38] The Official Receiver will usually endorse the petition, at which point the debtor will be considered formally bankrupt.[39] However, the Official Receiver retains a discretion to refuse a debtor's petition if it appears the debtor is solvent or if the debtor has been bankrupt at least three times or at least once in the last five years.[40]

6.2.3.2 Involuntary bankruptcy – commencement

A creditor's petition can be presented against an individual debtor, a partnership or joint debtors.[41] In each case, the individual debtor or debtors must have a relevant jurisdictional connection with Australia[42] and must owe the petitioning creditor a debt or debts of not less than AUD 5,000.[43]

Involuntary bankruptcy is premised on the debtor having committed an "act of bankruptcy" within the six-month period immediately preceding the presentation of the creditor's petition.[44] The most common act of bankruptcy relied on by a creditor is the bankrupt having failed to comply with a bankruptcy notice. If an act of bankruptcy is established, it is not necessary for a creditor to prove that the debtor is in fact insolvent. Rather, insolvency is presumed. However,

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35 Bankruptcy Act, ss 56A, 57.
36 *Idem*, s 54A.
37 *Idem*, ss 54E, 54L.
38 *Idem*, s 55(2).
39 *Idem*, s 55(4A).
40 *Idem*, s 55(3AA).
41 *Idem*, ss 7, 45, 46.
42 *Idem*, s 43(1)(b).
43 *Idem*, s 44(1)(a).
44 *Idem*, ss 43, 44(1)(c).

the court retains a discretion to dismiss a creditor's petition if it is satisfied, upon proof by the debtor, that the debtor is able to pay their debts as and when they fall due.[45]

Involuntary bankruptcy commences when the court makes a sequestration order against the debtor's estate.

6.2.3.3 Appointment and role of the bankruptcy trustee

The Official Trustee in Bankruptcy (operated by AFSA) or a private registered trustee will act as the trustee of the bankrupt estate.

The assets of the bankrupt vest in (that is, they become the property of) the bankruptcy trustee.[46] This applies both to the bankrupt's assets in existence at the commencement of the bankruptcy and any assets acquired by the bankrupt after commencement of the bankruptcy and before discharge. For registered assets such as land, the bankruptcy trustee has the right to have the registration transferred into their name.

The bankruptcy trustee's initial task is to examine the books and records of the debtor with a view to thoroughly investigating the debtor's affairs, the scope of the debtor's property and any transactions which have been entered into that may have infringed the voidable transaction provisions of the Bankruptcy Act (discussed in paragraph 6.2.3.11 below).

The bankruptcy trustee then proceeds to investigate the debtor's property and affairs, realise the debtor's assets (including managing the debtor's business, if relevant), collect income contributions from the debtor (see paragraph 6.2.3.6 below) and make distributions to creditors.

6.2.3.4 Bankruptcy moratorium and its exceptions

When a debtor becomes bankrupt, creditors are prevented from, in relation to all "provable debts":

- enforcing any remedy against the person or property of the debtor; and
- except with the leave of the court, commencing any new legal proceeding or taking a fresh step in an existing proceeding against the person or property of the debtor.[47]

Provable debts are defined widely and include any future or contingent debts (such as a liability under a guarantee), to which the debtor may become subject before being discharged from bankruptcy, and which relate to an obligation incurred before the date of the bankruptcy.[48]

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45 *Idem*, s 52(2)(a).
46 *Idem*, s 58(1).
47 *Idem*, s 58(3).
48 *Idem*, s 82(1).

Certain claims are excluded, such as fines and civil penalties and claims for unliquidated damages which do not arise out of a contract, promise or breach of trust (for example, damages relating to a personal injury claim).[49]

Importantly, secured creditors are not bound by the bankruptcy moratorium. They remain entitled to enforce their rights.[50] If a secured creditor realises its security and there is a shortfall, the secured creditor may submit a proof of debt for the shortfall.[51]

6.2.3.5 Status of the debtor upon bankruptcy

An undischarged bankrupt is also prohibited from being a director or promoter of a company or otherwise taking part in the management of a company.[52]

Upon becoming bankrupt, the debtor is required to:

- provide information and assistance to the bankruptcy trustee;[53]
- surrender their passport to the bankruptcy trustee and obtain the consent of the trustee to travel overseas (non-compliance is also an offence);[54] and
- disclose that they are an undischarged bankrupt in connection with any application for credit over a prescribed amount (currently AUD 5,881, indexed annually).[55]

6.2.3.6 Divisible and non-divisible property

All of the debtor's property is "divisible property" which can be distributed by the bankruptcy trustee among creditors, except for certain limited types of "non-divisible property", including:

- property that was held on trust by the debtor for another person;
- certain household property reasonably necessary for domestic use;
- property used by the debtor to earn income by personal exertion up to a prescribed limit (currently AUD 3,800, indexed annually);
- the debtor's primary means of transportation, up to a prescribed limit representing the debtor's equity interest (currently AUD 8,100, indexed annually); and

[49] *Idem*, ss 82(2)-82(3AA).
[50] *Idem*, s 58(5).
[51] *Idem*, ss 90-91.
[52] *Corporations Act*, ss 206A, 206B.
[53] Bankruptcy Act, ss 54(1), 77(1).
[54] *Idem*, ss 77(1)(a)(ii), 272.
[55] *Idem*, s 269.

- insurance policy proceeds and superannuation funds.[56]

Divisible property includes choses in action (that is, legal rights to recovery, usually realised through legal proceedings) relating to the debtor's assets.[57] However, choses in action relating to personal injuries or wrongs done to the bankrupt, their spouse or family members, and any damages or compensation recovered from such, are non-divisible property.[58]

6.2.3.7 Contracts

Executory contracts entered into by a debtor prior to their bankruptcy remain enforceable once the debtor becomes bankrupt. The bankruptcy trustee has the benefit of a statutory *ipso facto* prohibition, which renders void any provision in a contract that purports to provide a counter-party with a right to terminate, modify or repossess property upon the debtor's bankruptcy.[59]

The bankruptcy trustee is entitled to disclaim a contract (as well as certain other property such as land burdened with onerous covenants and property that is not readily saleable) by giving written notice to the counter-party, subject to first obtaining the leave of the court if the contract is not an "unprofitable contract".[60] If a contract is disclaimed, the counter-party will have a claim for damages but will be required to submit a proof of debt to recover the loss.[61]

There are no special rules for the treatment of essential contracts (such as those relating to the provision of water, electricity and communication services).

6.2.3.8 Proofs of debt and set-off rights

All creditors with provable claims must submit a written proof of debt. If a creditor's proof of debt is rejected by the bankruptcy trustee, the creditor may apply to the court to review the bankruptcy trustee's decision.[62]

Where the creditor and the debtor have had mutual dealings, the amounts owed by debtor and creditor are subject to a mandatory, automatic set-off. A proof of debt may only be submitted for any remaining balance.[63]

6.2.3.9 Distribution of the bankrupt estate and priority claims

The bankruptcy trustee is first required to pay certain priority amounts, including, in order:

- the costs and expenses of the administration of the bankruptcy;

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[56] *Idem*, ss 116(1), 116(2); Bankruptcy Regulations, regs 6.03-6.03B.
[57] Bankruptcy Act, s 60(2).
[58] *Idem*, ss 60(4), 116(2)(g).
[59] *Idem*, s 301.
[60] *Idem*, ss 133(1AA), 133(1AB), 133(1A), 133(5A).
[61] *Idem*, s 133(8).
[62] *Idem*, s 104(1).
[63] *Idem*, s 86, *Gye v McIntyre* (1991) 171 CLR 609.

- costs and expenses relating to any prior failed personal insolvency agreement or composition or scheme (discussed at paragraph 6.2.4.1 below);

- any unpaid wages, including superannuation, of the debtor's employees; and

- creditors agreed by special resolution of all creditors or court order to receive special priority, for example, to compensate the creditor for indemnifying the bankruptcy trustee for the legal costs of initiating court proceedings to enforce the voidable transaction provisions of the Bankruptcy Act (discussed in paragraph 6.2.3.11 below).[64]

The remaining creditors are to be paid *pari passu* (that is, proportionately) from the remaining assets.[65] In practice, the payment of priority creditors usually exhausts all, or the vast majority of, the bankrupt estate. Ordinary unsecured creditors receive few, if any, dividends.

6.2.3.10 Voidable transaction provisions

There are three types of voidable transaction provisions (known as clawback or anti-avoidance provisions in some other jurisdictions) in the Bankruptcy Act which allow the bankruptcy trustee to bring court proceedings to reverse the effect of:

- undervalued transactions;

- transfers to defeat creditors; or

- preferential payments to creditors.

Most voidable transaction provisions (in both bankruptcy and corporate insolvency) target transactions which occurred during a certain period of time (called the "relation-back period") prior to the "commencement of bankruptcy". Importantly, the commencement of bankruptcy is not the same as the actual date a debtor becomes bankrupt. In the case of involuntary bankruptcy, the commencement of bankruptcy is the time of the commission of the earliest act of bankruptcy occurring within the six-month period immediately before the presentation of a creditor's petition.[66] In the case of voluntary bankruptcy, the commencement of bankruptcy is usually the date that the debtor's petition is presented, but it can be earlier.[67]

Transactions which occurred during the relation back period but were transacted in good faith, in the ordinary course of business and in the absence of notice of a creditor's petition or debtor's petition, are not recoverable under the voidable transaction provisions.[68] Also, the bankruptcy trustee will not be able to recover property if the original transferee has since transferred the

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[64] Bankruptcy Act, s 109.
[65] *Idem*, s 108.
[66] *Idem*, s 115(1).
[67] *Idem*, s 115(2).
[68] *Idem*, s 123.

property to a third party and the third party received the property in good faith and for market value.[69]

Undervalued Transactions

To recover an undervalued transaction, the bankruptcy trustee must show that:

- the transaction took place in the five-year period before the commencement of the bankruptcy; and
- the transferee gave no consideration or less than market value consideration for the transfer.[70]

It is a defence for a transferee to show that the transaction occurred more than two years ago (or more than four years ago for related party transactions) and that the debtor was solvent at that time.[71]

Transfers to Defeat Creditors

To recover a transfer of property to defeat creditors, the bankruptcy trustee must show that the debtor's main purpose was to prevent, hinder or delay creditors from being paid.[72] The bankruptcy trustee is given the benefit of a statutory presumption, so that a debtor will be taken to have the proscribed purpose if it can be inferred that, at the time of the transfer, the debtor was or was about to become insolvent.[73]

There is no specific relation-back period. Any transfer to defeat creditors regardless of how early it occurred is recoverable by the bankruptcy trustee.

It is a defence for the transferee to show that:

- it paid market value for the property; and
- at the time of the transfer, the transferee did not know and could not reasonably have inferred either that:
  - the transferor had the main purpose of defeating creditors; or
  - the transferor was insolvent or about to become insolvent.[74]

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[69] *Idem*, s 120(6), s 121(8).
[70] *Idem*, s 120(1).
[71] *Idem*, s 120(3).
[72] *Idem*, s 121(1). While s 121(1) is expressed in general terms to permit the recovery of any kind of transfer by a debtor intended to defeat, hinder or delay the claims of creditors, the Bankruptcy Act also contains specific provisions mirroring the general recovery provision in the context of superannuation contributions made by or on behalf of a debtor to defeat creditors: ss 128B, 128C.
[73] *Idem*, s 121(2).
[74] *Idem*, s 121(4).

Preferential Payments

A bankruptcy trustee is entitled to recover a transfer of property made by a debtor to a creditor in the six months prior to the presentation of a debtor's or creditor's petition, if:

- the debtor was insolvent at the time of the transfer; and
- the effect of the transfer was to give the creditor a preference, priority or advantage over other creditors.[75]

It is a defence for a creditor to show that it received the payment in good faith, in the ordinary course of business and in return for valuable consideration (with only new consideration, for example the supply of new goods or services by the creditor, as distinct from the discharge of indebtedness related solely to past goods or services, sufficient for that purpose).[76]

6.2.3.11 Discharge and Annulment

Bankruptcy ends when the debtor is discharged or the bankruptcy is annulled.

Discharge occurs automatically three years from the date the debtor files their statement of affairs with the bankruptcy trustee, unless the trustee lodges an objection to discharge on the basis that the debtor has failed to co-operate during the administration of the bankruptcy, in which case the bankruptcy period will be extended to either five years or eight years from the date the statement of affairs was filed by the debtor.[77]

The effect of discharge is that the debtor is released from all provable debts and is no longer required to make income contributions to the bankruptcy trustee.[78] However, the bankrupt estate continues to be administered and property which became vested in the bankruptcy trustee during the bankruptcy remains under the control of the trustee and does not re-vest in the debtor, so that such property can continue to be used to meet any outstanding provable debts.

Bankruptcy may be annulled when:

- all of the provable debts in the bankruptcy have been paid;[79]
- the court determines that a sequestration order was invalidly made or the conditions for presenting a debtor's petition were not met;[80] or

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75 *Idem*, s 122(1).
76 *Idem*, s 122(2)(a).
77 *Idem*, ss 149-149D.
78 *Idem*, s 153(2).
79 *Idem*, s 153A.
80 *Idem*, s 153B.

- creditors accept, by special resolution at a meeting of creditors, a scheme of arrangement or composition proposed by the debtor.[81] A scheme or composition is essentially a financial arrangement put forward by a debtor after the date of bankruptcy (in contrast to a personal insolvency agreement or debt agreement proposed before bankruptcy: see paragraph 6.2.4 below) under which creditors receive a greater return than they would by continuing with the bankruptcy. This will usually involve the debtor arranging for a relative or associate to inject funds into the bankrupt estate to distribute to creditors).

Following annulment, the bankrupt administration ends and property which was previously vested in the bankruptcy trustee will (unlike discharge) generally re-vest in the debtor.

6.2.4 Non-bankruptcy alternatives

6.2.4.1 Personal insolvency agreements

A debtor, or joint debtors, may only propose a personal insolvency agreement to their creditors if the debtor is insolvent and has a relevant jurisdictional connection with Australia.[82] The personal insolvency agreement must include certain prescribed matters, such as:

- a description of the debtor's property and income and how the property and income will be collected and distributed to creditors;
- the extent the debtor will be released from any provable debts;
- the person nominated to act as the trustee of the agreement; and
- whether it is proposed the voidable transaction provisions of the Bankruptcy Act (discussed in paragraph 6.2.3.11 above) will apply to permit recoveries by the trustee – in that regard, the application of the voidable transaction provisions depends entirely on the terms of the personal insolvency agreement and is not, unlike during bankruptcy, automatic.[83]

The personal insolvency agreement will be accepted and if approved by at least 50% in number and 75% in value of all unsecured creditors voting at a meeting of creditors.[84] Once the agreement is executed, it is binding on all unsecured creditors including dissenting creditors.[85]

In practice, personal insolvency agreements are used by debtors with business interests and significant liabilities who also have access to third party funds which can be made available to creditors (and which would otherwise not be available in a formal bankruptcy) as an incentive for creditors to accept the personal insolvency agreement. A personal insolvency agreement avoids the negative reputational impact of bankruptcy and the adverse personal consequences of entering formal bankruptcy, including travel restrictions, the disclosure of bankruptcy to new

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81 *Idem*, s 73.
82 *Idem*, ss 187(1), s 187A, 188(1).
83 *Idem*, s 188A.
84 IPRB, r 75-132.
85 Bankruptcy Act, s 229.

financiers and mandatory income contributions. However, a debtor who enters a personal insolvency agreement which remains unperformed is still disqualified from managing companies in the same manner as an undischarged bankrupt.[86]

6.2.4.2 Debt agreements

Debt agreements are designed for individual debtors with smaller debts, income and available assets. The debtor's unsecured debts must be less than AUD 118,063.40, their divisible property must be worth less than AUD 236,126.80 and their annual after-tax income must not exceed AUD 88,547.55.[87] These amounts are indexed annually.

Reforms were introduced in mid-2019,[88] doubling the divisible property limit and limiting debt agreements to 3 years (or 5 years if the debtor owns their own home). A further requirement that the total proposed payments under the debt agreement not exceed the debtor's annual after-tax income by a prescribed percentage is also to be introduced but as at 30 August 2019, the prescribed percentage has not yet been set. These amendments are intended to provide greater protection for debtors by preventing them from too readily entering into a debt agreement which they cannot afford, further adding to their financial stress.

The debt agreement is accepted if a majority in value of creditors who reply to the Official Receiver vote in favour of the agreement.[89] If accepted, it is then administered by an appointed "administrator" and is binding on all unsecured creditors.

Self-Assessment Exercise 3

What options are available for an individual to deal with their indebtedness outside the formal bankruptcy process in Australia? What are the incentives for a person to do so?

For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

6.3 Corporate liquidation

6.3.1 Relevant legislation and scope of application

Australia's corporate liquidation regime is set out in the Corporations Act, which applies to the vast majority of companies incorporated in Australia.

[86] Corporations Act, s 206B(4).
[87] Bankruptcy Act, s 185C(4).
[88] As a result of the passage of the Bankruptcy Amendment (Debt Agreement Reform) Act 2018 (Cth) (Reform Act).
[89] Bankruptcy Act, s 185EC.

The Corporations Act also allows for the winding up in Australia of:[90]

- a registered foreign company; or
- an unregistered foreign company that is, or was, carrying on business in Australia.

The Corporations Act also provides that, if the company is already being wound up overseas, an Australian liquidator can be appointed by an Australian court.[91]

Australian corporate insolvency law applies to all of the company's assets worldwide.

Although not otherwise discussed in this Module, it should be noted that for a minority of specific types of Australian companies, the liquidation process is regulated under alternative legislation, for example:

- certain Aboriginal and Torres Strait Islander organisations, which are regulated by the Corporations (Aboriginal and Torres Strait Islander) Act 2006 (Cth);
- life insurance companies, which are regulated by the Life Insurance Act 1995 (Cth); and
- banks, which are regulated by the Banking Act 1959 (Cth).

6.3.2 Types of corporate liquidation

There are three different types of corporate liquidation (or "winding up") in Australia:

- members' voluntary liquidation;
- creditors' voluntary liquidation (with both normal and "simplified" versions); and
- compulsory liquidation.

There is no obligation on a company to enter into formal insolvency proceedings if it becomes insolvent.

6.3.3 Members' voluntary liquidation

A members' voluntary liquidation can only take place where the company is solvent. It is used to wind up companies that are no longer required. Because a members' voluntary liquidation is premised on the company being solvent, all creditors will be paid in full and accordingly this form of external administration does not involve creditors in the liquidation process.

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[90] Corporations Act, s 583, s 601CL(15) and (16).

[91] *Idem*, s 601CL(14).

For a company to enter a members' voluntary liquidation, it is first necessary for directors to make a written declaration that, after conducting enquiries into the company's affairs, they are of the opinion that the company will be able to pay all of its debts as and when they fall due within 12 months of the proposed commencement of the liquidation.[92] The declaration must then be lodged with ASIC before a meeting of shareholders is called to consider whether to pass a special resolution to wind up the company. The special resolution will only be passed if it is supported by 75% of the shareholders who attend and vote at the meeting.[93]

If, assuming the resolution is passed and a liquidator is appointed, the liquidator at any time forms the view that the company is in fact insolvent, meaning that it will not be able to pay its debts as and when they become due and payable (this is a "cash flow" insolvency test as is the case for personal insolvency under the Bankruptcy Act),[94] the liquidator must appoint a voluntary administrator or otherwise take steps to convert the liquidation to a creditors' voluntary winding up or a compulsory liquidation.[95]

As a members' voluntary liquidation is not an insolvency process, it will not be further discussed in this module.

6.3.4 *Creditors' voluntary liquidation*

Under a creditors' voluntary liquidation, a liquidator can be appointed:

- by special resolution of shareholders if the directors believe the company is insolvent. The liquidator must then convene a meeting of creditors within 10 business days, with creditors given the power to replace the liquidator, request information and reports and / or appoint a committee of inspection;[96] or

- if resolved by creditors at the second meeting of creditors held during voluntary administration (discussed in paragraph 6.5.2.6 below).[97]

As of 1 January 2021, there will be two different forms of creditors' voluntary liquidation: the normal version and a simplified version for small companies. The new "simplified liquidation process" will only be available to businesses with total liabilities of less than AUD 1 million and it applies only in the context of a creditors' voluntary liquidation. The new process is discussed in paragraph 6.3.17 below.

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[92] *Idem*, s 494.
[93] *Idem*, ss 249H(1), 491.
[94] *Idem*, s 95A.
[95] *Idem*, s 496.
[96] *Idem*, s 497.
[97] *Idem*, s 439C(c).

6.3.5 *Compulsory liquidation*

Compulsory liquidation takes place when the court makes an order, on the application of an interested party, for the company to be wound up in insolvency.[98]

Usually, the application will be made by an unpaid creditor of the company. While compulsory liquidation is premised on the company being insolvent, there are various statutory presumptions of insolvency which a creditor may resort to in order to avoid the evidentiary difficulty of proving that the company is in fact insolvent.

In practice, the most common presumption of insolvency resorted to by a creditor is the company's failure to comply with a statutory demand previously served by the creditor requiring the company to pay an outstanding debt owing to the creditor (which must have a value of at least AUD 2,000) within the prescribed 21-day time period under the Corporations Act.[99] In that regard, statutory demands play a similar role to bankruptcy notices issued as part of the personal insolvency process (see paragraph 6.2.3.2 above).

6.3.6 *Appointment and role of a liquidator*

For a creditors' voluntary liquidation, the liquidator is initially appointed by the members of the company after they resolve for the company to be wound up. However, as noted in paragraph 6.3.4 above, creditors retain the ability to replace the liquidator with their own nominee at a subsequent meeting of creditors. Alternatively, if creditors resolve for a company to be placed into liquidation at the second meeting of creditors during the course of a voluntary administration of the company, then the voluntary administrator himself becomes the liquidator, unless the creditors appoint some other person as liquidator.[100]

In the case of compulsory liquidation, when the court makes a winding up order, it will also appoint the registered liquidator nominated by the creditor that initiated the winding up application, so long as the registered liquidator has provided a written consent to be appointed.[101]

Pending the hearing of a winding up application, the court may also make an order appointing a provisional liquidator.[102] That course will be appropriate where there is a risk of the company's assets being dissipated or removed by directors, thereby diminishing the pool of funds that would be available for distribution to creditors if a final winding up order were to be made by the court. That risk, in conjunction with a company's apparent or probable insolvency, is usually sufficient for a court to exercise its discretion to appoint a provisional liquidator.[103] However, in practice, the appointment of a provisional liquidator is rare.

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[98] *Idem*, ss 459A, 459P.
[99] *Idem*, ss 459C(2)(a), 459E, 459F, 459Q.
[100] *Idem*, ss 439C(c), 446A, 499.
[101] *Idem*, s 472(1).
[102] *Idem*, s 472(2).
[103] *ASIC v Tax Returns Australia Dot Com Pty Ltd* [2010] FCA 715.

Upon the appointment of a liquidator in connection with a creditors' voluntary liquidation or a compulsory liquidation, directors remain in office but their management powers are suspended.[104] Following the appointment, a liquidator will proceed to:

- take possession of the company's property;

- obtain and examine the books and records of the company for the purpose of ascertaining the scope of the company's property, the circumstances which led to the company's liquidation and any transactions which may have contravened the voidable transaction provisions of the Corporations Act (see paragraph 6.3.14 below);

- seek the assistance of directors in connection with the liquidator's investigations, with directors required to complete a report as to the affairs of the company and attend on the liquidator and provide such information as is reasonably required;[105]

- if directors are not co-operative, a liquidator may seek to publicly examine them, and other persons who may be able to provide information in relation to the company, in a court hearing convened specifically for that purpose,[106] such public examinations being a powerful and extremely useful tool in the liquidator's information gathering process;

- regularly communicate with creditors, including by advising creditors of the liquidator's appointment and of their rights during the liquidation, calling for proofs of debt to be submitted to the liquidator, providing an initial remuneration notice and other information relevant to the liquidator's remuneration and providing a statutory report on the liquidation within three months of the appointment (which must include advice on whether any transactions are likely to have contravened the voidable transaction provisions of the Corporations Act as well as the likely dividend that will be received by creditors in the liquidation);[107]

- realise and distribute the company's property to creditors.

A liquidator's role is a hybrid of fiduciary, agent, officer of the company and officer of the court.[108] A liquidator is also subject to the same statutory duties as a director, including to act with reasonable care and diligence, in good faith, for a proper purpose and in the best interests of the company and to avoid conflicts of interest.[109]

In the latter regard, a liquidator must not only be independent in fact but also avoid any appearance of conflict. A perceived lack of independence is sufficient to justify the removal of a

[104] *Idem*, s 198G(1).
[105] *Idem*, s 530A.
[106] *Idem*, ss 596A-596B.
[107] IPRC, rr 70-30, 70-35, 70-40, 70-45.
[108] *Sydlow Pty Ltd v TG Kotselas Pty Ltd* (1996) 65 FCR 234.
[109] Corporations Act, ss 180-184.

liquidator,[110] or alternatively the appointment of a "special purpose liquidator" to act in relation to the particular area in which the primary liquidator is conflicted.[111]

6.3.7 Liquidation moratorium and its exceptions

The Australian liquidation moratorium applies only to unsecured creditors and not to secured creditors. There are two elements to the moratorium: i) a stay on enforcement action against the assets of the company[112] and ii) a stay of proceedings against the company.[113]

Unsecured creditors cannot enforce their rights during a liquidation outside of the liquidation process, whether by attachment, execution or court proceedings.[114] However, the court may grant leave for court proceedings to be commenced or continued against the company where it is appropriate to do so. Although leave is usually not granted, circumstances justifying a grant of leave include:

- where the proceedings were already well advanced before the liquidation began; or
- where the claim is of such complexity that it is better determined by the court than by the liquidator in adjudicating on a proof of debt; and
- in combination with either of the above, where it is likely that any decision by the liquidator in adjudicating on the proof of debt would be the subject of an appeal to the court by the creditor.

Secured creditors are permitted to enforce any rights that they have under any valid security interest.[115]

6.3.8 Assets available for distribution to creditors

In corporate liquidation, unlike bankruptcy, the assets of the company remain the property of the company and do not vest in the liquidator. However, the liquidator has complete control over the company and all necessary powers to deal with the assets of the company.[116]

In a compulsory or creditors' voluntary liquidation, all "property of a company" is available to be divided among the unsecured creditors.[117] However, any property held on trust and any property the subject of a security interest is not "property of the company" in this sense.
In a liquidation, the company's secured assets are likely to be under the control of a privately-appointed receiver. If a secured creditor holds security over all of the assets of the company,

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[110] *Re Club Superstores Australia Pty Ltd* (1993) 10 ACSR 730.
[111] *McGrath; Re HIH Insurance Ltd* [2006] NSWSC 385.
[112] Corporations Act, s 471B.
[113] *Idem*, ss 471B, 500(2).
[114] *Idem*, ss 471B, 500(2), s 468(4).
[115] *Idem*, s 471C.
[116] *Idem*, s 477.
[117] *Idem*, s 501.

then it will be the receiver rather than the liquidator who will operate the business of the company and arrange the sale of assets. If for some reason the secured creditor does not appoint a receiver or does not itself seek to realise the secured assets, then the liquidator can realise the secured assets but must pay the proceeds, less the costs of realising the asset,[118] to the secured creditor.

Even if a receiver has control of the assets of the company, the liquidator will still have important work to do. In particular, there are causes of action available to a liquidator in relation to voidable transactions and insolvent trading that are not available to a receiver. The proceeds of these causes of action are only available to the general body of unsecured creditors (including for payment of liquidator's costs and fees). They cannot be caught by a security interest.[119]

Until fairly recently, voidable transaction and insolvent trading claims could only be pursued by a liquidator and could not be assigned. This meant that in assetless liquidations, such claims would only be pursued if the liquidator could obtain litigation funding. In commercial litigation funding, the funder takes 40% or more of the proceeds if the litigation is successful. The other source of litigation funding is the Australian Taxation Office, which has a fund available to it for funding litigation by liquidators where there is likely to be a return to the tax office on its proof of debt if the litigation is successful.

On 1 March 2017, the Corporations Act was amended to permit liquidators to assign voidable transaction and insolvent trading claims. By selling these claims, liquidators will be able to quickly realise an asset for the benefit of unsecured creditors, although naturally the amount for which the claim can be sold will be less than the potential realisations if the claim is successful.[120]

6.3.9 Contracts

During a creditors' voluntary liquidation or a compulsory liquidation, the liquidator is entitled to disclaim certain property, such as land burdened with onerous covenants, unsaleable property and contracts.[121]

A disclaimer terminates the company's rights and liabilities in the relevant property and leaves a counter-party to lodge a proof of debt for its loss with the liquidator (proofs of debt are discussed in further detail in paragraph 6.3.10 below).[122] The High Court of Australia has confirmed that a liquidator's power to disclaim property extends to the disclaimer by a liquidator of an insolvent landlord of a tenant's leasehold interest, allowing the liquidator to then sell the underlying assets and leaving the tenant to lodge a proof of debt for its loss as an unsecured creditor.[123]

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[118] The right of the liquidator to keep the costs of realising the secured asset is known in Australia as the "*Universal Distributing* principle", from the High Court of Australia case of *Universal Distributing Co Ltd (in liq)* (1933) 48 CLR 171; affirmed in *Stewart v Atco Controls Pty Ltd (in liq)* (2014) 252 CLR 307.

[119] *NA Kratzmann Pty Ltd (in liq) v Tucker (No 2)* (1968) 123 CLR 295.

[120] IPSC, s 100-5.

[121] Corporations Act, s 568.

[122] *Idem*, s 568D.

[123] *Willmott Growers Group Inc v Willmott Forests Limited* (2013) 251 CLR 592.

Notably, however:

- as is the case during bankruptcy (see paragraph 6.2.3.7 above), a contract can only be disclaimed by a liquidator with the court's leave unless the contract is "unprofitable" or involves a lease of land;[124] and

- a counter-party may, if property is disclaimed, apply to the court seeking to have the disclaimer set aside before or after it takes effect. In exercising its discretion to set aside the disclaimer, the court will consider whether prejudice to the counter-party from the disclaimer is "grossly out of proportion" to the prejudice the company's creditors and other parties would suffer if the disclaimer were to be set aside.[125]

There are no special rules for the treatment of essential contracts (such as those relating to the provision of water, electricity and communication services).

Liquidators do not have the benefit of the *ipso facto* enforcement prohibition that applies during voluntary administrations, so a supplier or other contractor is generally able to terminate its contract with the company as soon as the company enters liquidation (assuming *ipso facto* rights have been incorporated in the contract).

6.3.10 Proofs of debt

The process for a creditor to submit a proof of debt during a creditors' voluntary liquidation or a compulsory liquidation is broadly similar to that which applies during the bankruptcy of an individual debtor (see paragraph 6.2.3.8 above).[126] The key difference during liquidation is that more claims are classed as provable debts than during bankruptcy. That is because, while a bankrupt remains personally liable for non-provable debts even following the discharge or annulment of the bankruptcy, at the conclusion of a liquidation the company is deregistered and ceases to exist (see paragraph 6.3.16 below), so that a non-provable debt can no longer be recovered at all. Therefore, for example, while a claim for unliquidated damages in tort is not a provable debt in bankruptcy, it is classed as a provable debt in a company's liquidation.

As in bankruptcy, penalties and fines imposed on a company, are not provable debts in a company's liquidation.[127] The exception is justified on the policy basis that it is better for the "public purse" to suffer loss than unsecured creditors of the company, who would receive a lesser dividend if penalties and fines counted as provable debts.

6.3.11 Set-off

As in bankruptcy (see paragraph 6.2.3.8 above), in a creditors' voluntary liquidation or compulsory liquidation, where there have been mutual credits, debts or other mutual dealings

[124] Corporations Act, s 568(1A).
[125] *Idem*, ss 568B, 568E.
[126] *Idem*, s 553E.
[127] *Idem*, s 553B.

between the company and a creditor, a mandatory statutory set-off will apply.[128] The statutory set-off arises automatically when the required mutuality exists and prevails over any contrary agreement between the parties.[129]

6.3.12 Pooling provisions

Where multiple companies in a corporate group are being wound up by the same liquidator simultaneously, the Corporations Act makes provision for the liquidation of those companies to proceed on a pooled basis, either by:

- voluntary pooling, which occurs when, following a determination by the liquidator that liquidation should occur on a pooled basis, 75% of unsecured creditors by value and 50% of unsecured creditors by number of each of the companies in the proposed pooled group approve the liquidator's determination;[130] or

- court-ordered pooling, which occurs when, on the application of a liquidator, the court orders that it is just and equitable for liquidation to proceed on a pooled basis.[131]

However, there is no provision in Australia for broader "contribution orders" of the kind seen in the United States (under the substantive consolidation process) and New Zealand to be made by the court for the purpose of bringing a solvent group company into the pool where it is in the interests of justice to do so. While, as discussed in paragraph 9.2 below, legislation has been passed to permit contribution orders to be made against a solvent group company in those circumstances to ensure additional funds are made available to pay employee entitlements, there will still not be any general mechanism for the court to make a pooling order to benefit all creditors of an insolvent company within a corporate group.

6.3.13 Distribution of the insolvent estate and priority claims

After collecting and realising the assets of the company in a creditors' voluntary liquidation or compulsory liquidation, the liquidator proceeds to distribute the assets. The starting position, encapsulating the *pari passu* principle, is that the available assets are to be distributed equally among all creditors that have submitted proofs of debt accepted by the liquidator.[132]

However, certain priority creditors are entitled to be paid their claims first. The priority claims include, in descending order:

- costs incurred by the liquidator (or any prior voluntary administrator) in collecting, preserving and realising property of the company or in carrying on the company's business;

- the costs of a creditor in applying for a compulsory winding up order;

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[128] *Idem*, s 553C.
[129] *GM & AM Pearce & Co Pty Ltd v RGM Australia Pty Ltd* [1998] 4 VR 888.
[130] Corporations Act, ss 571, 578; IPRC, r 75-180.
[131] *Idem*, ss 579E, 579G.
[132] *Idem*, s 555.

- certain debts incurred by any voluntary administrator who was appointed to the company before the liquidation took place (other than the amounts referred to above);
- the remuneration of the liquidator; and
- wages, superannuation contributions, outstanding leave entitlements and retrenchment payments for employees of the company.[133]

There is a particular mechanism in Australia, the Fair Entitlements Guarantee Scheme, which is administered by the Government to ensure that employees are paid their outstanding employee entitlements in the event of a company's liquidation. Under the Fair Entitlements Guarantee Scheme, employees submit their claims for unpaid wages and other amounts to the Government, which then pays the outstanding amounts. The Government then becomes entitled, by way of a statutory right of subrogation, to assume the priority position that the employee would have enjoyed in the distribution of the company's assets by the liquidator.[134]

As noted in paragraph 6.3.7 above, secured creditors are generally entitled to remain outside the liquidation process, enforcing their security interests to meet the debts owed to them. However, as mentioned above, to the extent a secured creditor has a circulating security interest, proceeds from the sale of assets subject to the security interest must first be used to meet any outstanding employee entitlements which remain after the company's free assets have been exhausted.[135] The relevant secured creditor is then entitled to any surplus.

Where employees have been paid by the Government under the Fair Entitlements Guarantee Scheme, the Government takes over the employees former rights to payment. It is therefore the Government that has been the principal litigant in court cases to determine whether secured assets are subject to a circulating security interest (and therefore payable to the Government in respect of employee entitlements) or to a non-circulating security interest (and therefore payable directly to the secured creditor).

Apart from the priority claims noted above, the court may, as is the case during the bankruptcy process for insolvent individuals (see paragraph 6.2.3.10 above), also grant a creditor special priority in circumstances where the creditor has advanced funds to the liquidator for the purpose of initiating legal proceedings to recover transactions which contravene the voidable transaction provisions of the Corporations Act.[136]

As a further modification to the *pari passu* principle, all debts owed to a creditor in its capacity as a shareholder of the company (for example in relation to unpaid dividends) are expressly postponed until the payment of all other unsecured creditors.[137]

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[133] *Idem*, s 556.
[134] *Idem*, s 560.
[135] *Idem*, s 561.
[136] *Idem*, s 564.
[137] *Idem*, s 563A.

6.3.14 Voidable transaction provisions

Under Part 5.7B of the Corporations Act, a liquidator has the power to avoid transactions which are:

- unfair preferences;
- uncommercial transactions;
- unreasonable director-related transactions;
- unfair loans; or
- circulating security interests (in limited circumstances).

6.3.14.1 Unfair preferences

If a company makes a payment to a creditor which:

- occurred at a time:
    - in the six-month period ending on the "relation back day" (generally the time the winding up application was filed for compulsory liquidation and the date members resolved to wind up the company, or the date that any earlier period of voluntary administration commenced, for a creditors' voluntary winding up);[138]
    - in the four-year period ending on the relation back day where the creditor is a related entity of the company;[139]
    - in the 10-year period ending on the relation back day where the transaction was entered into for a purpose which included defeating, delaying or interfering with the rights of creditors in the event of insolvency;[140] or
    - after the relation back day but on or before the liquidator was appointed;[141]
- occurred when the company was insolvent or otherwise caused the company to become insolvent;[142] and

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[138] *Idem*, ss 9, 588FE(2)(b)(i).
[139] *Idem*, s 588FE(4).
[140] *Idem*, s 588FE(5).
[141] *Idem*, s 588FE(2)(b)(ii).
[142] *Idem*, ss 588FC, 588FE(2)(a), 588FE(4)(a), 588FE(5)(a).

- enabled the creditor to recover more than it would if it had instead merely received a proportionate distribution of the company's assets as an unsecured creditor in a liquidation of the company,[143]

the liquidator may apply to the court for an order reversing the transaction.

While, unlike the comparable provision which applies during bankruptcy (see paragraph 6.2.3.11 above), the Corporations Act does not expressly require an element of disadvantage to the company before there can be an unfair preference, the courts in Australia have indicated that it is necessary to look at the ultimate effect of a transaction in assessing whether there is an unfair preference, so that if new goods or services are provided to the company by a creditor in return for payment (as distinct from the discharge of a pre-existing debt relating to the past supply of goods or services), there will not be an unfair preference.[144]

Where a creditor repays an unfair preference, the creditor is entitled to prove in the liquidation for their debt.[145]

6.3.14.2 Uncommercial transactions

If a company enters into a transaction with any person (not just a creditor) in circumstances where the transaction:

- occurred at a time:
    - in the two-year period ending on the relation back day;[146]
    - in the four-year period ending on the relation back day where the other person is a related entity of the company;[147]
    - in the 10-year period ending on the relation back day where the transaction was entered into for a purpose which included defeating, delaying or interfering with the rights of creditors in the event of insolvency;[148] or
    - after the relation back day but on or before the liquidator was appointed;[149]
- occurred when the company was insolvent or otherwise caused the company to become insolvent;[150] and

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143 *Idem*, s 588FA(1).
144 *VR Dye & Co Peninsula Hotels Pty Ltd (in liq)* (1999) 32 ACSR 27; *McKern v Minister Administering the Mining Act 1978 (WA)* (2010) 78 ACSR 630.
145 Corporations Act, s 588FI.
146 *Idem*, s 588FE(3)(b).
147 *Idem*, s 588FE(4).
148 *Idem*, s 588FE(5).
149 *Idem*, s 588FE(2)(b)(ii).
150 *Idem*, ss 588FC, 588FE(3)(a), 588FE(4)(a), 588FE(5)(a).

- is "uncommercial" in the sense that it would not have been entered into by a reasonable person in the company's circumstances, having regard to the benefits and detriments arising from the transaction,[151]

the liquidator may apply to the court for an order challenging the transaction.

6.3.14.3 Defences for unfair preferences and uncommercial transactions

The Corporations Act contains a limited defence against unfair preference and uncommercial transaction claims (but not unreasonable director-related transaction or unfair loan claims) pursuant to which the court cannot make an order permitting the recovery of property if it would materially prejudice a right or interest of a party to the transaction and that party:

- acted in good faith;
- was not in fact aware, and nor would any reasonable person in the party's circumstances be aware, of any reasonable grounds for suspecting the company was insolvent at the time of the transaction or would become insolvent by entering into the transaction; and
- provided valuable consideration or changed its position in reliance on the transaction.[152]

Other persons who were not parties to the relevant transaction are also protected from an adverse court order in similar circumstances.[153]

A creditor who has received an unfair preference is unable to use a statutory set-off as a defence to retain that unfair preference.[154]

6.3.14.4 Unreasonable director-related transactions

A liquidator can apply to the court to challenge an unreasonable director-related transaction of the company if it was entered into during the four years ending on the relation back day, or after that day but before the liquidator was appointed.[155]

Significantly, unlike unfair preferences and uncommercial transactions, an unreasonable director-related transaction can be recovered even if the company was not insolvent when the transaction was entered into or did not become insolvent by doing so.

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[151] *Idem*, s 588FB.
[152] *Idem*, s 588FG(2).
[153] *Idem*, s 588FG(1).
[154] *Morton as liquidator of MJ Woodman Electrical Contractors Pty Ltd v Metal Manufacturers Pty Ltd* [2021] FCAFC 228 at [7].
[155] *Idem*, s 588FE(6A).

To be an unreasonable director-related transaction:

- there must be a payment, transfer of property or issue of shares, or the incurring of an obligation to do so, in favour of either a director, a close associate of a director or a person, whether a natural person or a company, on behalf of or for the benefit of a director or close associate of a director; and

- a reasonable person in the company's circumstances would not have entered into the transaction having regard to the benefits and detriments arising from the transaction.[156]

6.3.14.5 Unfair loans

A liquidator can challenge an "unfair loan" provided to the company at any time before the appointment of the liquidator and regardless of whether the company was insolvent at the time of the loan or became insolvent as a result of the loan.[157]

A loan is deemed by the Corporations Act to be "unfair" if the interest or charges in relation to the loan are or at any time have been extortionate.[158]

6.3.14.6 Circulating security interests

Circulating security interests (formerly floating charges) created within six months before the commencement of liquidation and securing past indebtedness are void against the liquidator, unless the company was solvent immediately after granting the security.[159] Not only is the circulating security interest itself void, but the liquidator may also bring court proceedings to recover the proceeds of any realisation of the void circulating security interest.[160] However, this provision only applies in compulsory liquidations on grounds of insolvency. A liquidator in a creditors' voluntary liquidation can apply to the court to convert the liquidation to a compulsory liquidation on grounds of insolvency, in order to make use of this voidable transaction provision.[161]

A circulating security interest is deemed by the Corporations Act to be void against the liquidator if it has been created in the six-month period before the commencement of the external administration and the secured creditor has not provided new value (such as new goods or services) as consideration for taking the security interest.[162]

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[156] *Idem*, s 588FDA.
[157] *Idem*, s 588FE(6).
[158] *Idem*, s 588FD.
[159] *Idem*, s 588FJ.
[160] *Idem*, s 588FJ(6).
[161] *Idem*, s 459A, 459P; *Carter v New Tel Ltd* [2003] NSWSC 128.
[162] *Idem*, s 588FJ.

6.3.15 *Insolvent trading*

In Australia, a director will be liable for insolvent trading where:

- he or she was a director at the time a debt was incurred;
- the company was insolvent when the debt was incurred, or became insolvent as a result;
- there were reasonable grounds for suspecting the company was insolvent or would become so by incurring the debt;
- the director failed to prevent the company from incurring the debt; and
- the director was aware that there were reasonable grounds for suspecting the company was insolvent when it incurred the debt or a reasonable person in a like position in the company's circumstances would be so aware.[163]

Contravention of the insolvent trading provision usually results in a compensation order being made against the director, on the application of the company's liquidator (or individual creditors with the consent of the liquidator or the court).[164] The court can also impose a civil penalty,[165] a disqualification order[166] and, if a director has behaved dishonestly, a criminal penalty.[167]

The Corporations Act also imposes liability for insolvent trading on a holding company for the debts of an insolvent subsidiary in similar circumstances to those applying to directors.[168]

There are defences to insolvent trading where:

- there are reasonable grounds to expect solvency;
- there is a reasonable expectation of solvency based on information provided by a competent and reliable person fulfilling a responsibility to provide that information;
- a director did not take part in the management of a company because of illness or some other good reason; or
- a director took all reasonable steps to prevent the company from incurring the relevant debt, including by appointing a voluntary administrator.[169]

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[163] *Idem*, s 588G.
[164] *Idem*, ss 588M (proceedings by a liquidator), 588R and 588T (proceedings by an individual creditor).
[165] *Idem*, s 1317G.
[166] *Idem*, s 206C.
[167] *Idem*, s 588G(3).
[168] *Idem*, s 588V.
[169] *Idem*, s 588H.

From the above, it can be seen that insolvent trading liability in Australia is broader than in many other jurisdictions. In an attempt to reduce the stifling effect of the insolvent trading provisions on business rescue attempts, a "safe harbour" provision was introduced with effect from September 2017.

The safe harbour provisions provide that insolvent trading liability is not incurred where, after the time that directors begin to suspect the company may be or may become insolvent, they start developing one or more courses of action that are reasonably likely to lead to a better outcome for the company.[170] "Better outcome" is defined to mean an outcome that is better for the company than the immediate appointment of an administrator or liquidator.[171]

In determining whether a course of action is reasonably likely to lead to a better outcome for the company, a court may consider whether the directors have:

- properly informed themselves of the company's financial position;
- taken appropriate steps to prevent any misconduct by officers or employees;
- taken appropriate steps to ensure the company is keeping appropriate financial records;
- obtained advice from an appropriately qualified expert that a restructuring plan should be adopted and is likely to lead to a better outcome for the company; and
- proceeded to develop and implement the restructuring plan in consultation with the expert adviser.

The safe harbour only applies:

- to debts incurred directly or indirectly in connection with the proposed course of action, including ordinary trade debts incurred in the usual course of business or debts taken on for the specific purpose of effecting the plan;[172]
- if the company continues to pay all employee entitlements (including superannuation) as and when they fall due;[173] and
- if the company continues to comply with all tax reporting obligations.[174]

The policy reasons for the introduction of the safe harbour are explored in further detail in paragraph 6.5.4 below.

[170] *Idem*, s 588GA(1).
[171] *Idem*, s 588GA(7).
[172] *Idem*, s 588GA(1)(b).
[173] *Idem*, s 588GA(4).
[174] *Idem*, s 588GA(4).

6.3.16 Deregistration

After the liquidator has realised and distributed all of the company's property (or as much of the property as the liquidator can without protracting the liquidation indefinitely), the company will be deregistered by ASIC.[175] After it is deregistered, the company officially ceases to exist and any remaining nominal property vests in ASIC.[176]

If required, the company can be reinstated by ASIC of its own motion or in response to a court order for its reinstatement.[177] This may be appropriate, for example, to enable legal proceedings to be pursued against the company when the circumstances giving rise to a cause of action are only discovered after the deregistration has occurred.

6.3.17 Reform – small companies

As stated above, the Australian Government has introduced a "simplified liquidation process" for small companies. It applies to most of the framework of the existing liquidation regime but with adaptions to make the process less complex, less costly and swifter, so as to ensure greater returns for creditors and employees.[178]

6.3.17.1 Entering into the simplified liquidation process

The simplified liquidation process will only be available in a creditors' voluntary liquidation (not in a members' voluntary liquidation or a Court-ordered winding up) and only where:

- the company's total liabilities do not exceed AUD 1 million;[179] and
- no current director of the company (or a former director in the last 12 months) has been a director of another company that has undergone restructuring or been the subject of a simplified liquidation process within seven years.[180]

Where a liquidator believes on reasonable grounds that a company meets the eligibility criteria, the liquidator may adopt the simplified liquidation process.[181]

The liquidator must not adopt the simplified liquidation if at least 25% in value of the creditors have requested that the liquidator not follow the process.[182]

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175 *Idem*, ss 480(d), 481(3), 509, 601AB(2).
176 *Idem*, s 601AD.
177 *Idem*, s 601AH.
178 Explanatory Memorandum to the Corporations Amendment (Corporate Insolvency Reforms) Act 2020, [3.3], [3.14].
179 Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020, reg 5.5.03(1).
180 *Idem*, reg 5.5.03(2).
181 Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 500A(1).
182 *Idem*, cll 500A(2), 500AB, 500AD.

6.3.17.2 Features of the simplified liquidation process

The simplified liquidation process applies most of the features of a regular liquidation, except for the following key modifications:

- clawback of voidable transactions will only apply to unfair preferences of over AUD 30,000 that were paid to related parties of the company in the three months prior to the commencement of the liquidation;
- liquidators are only required to report to ASIC on potential misconduct where there are reasonable grounds to believe that misconduct has occurred (which eliminates the significant time and cost otherwise required to investigate all conduct before reporting to ASIC);
- removal of the requirement to hold creditor meetings and the removal of committees of inspection;
- simplification of the proof of debt process and the dividend process;
- provisions for electronic communications and voting.

The liquidator must cease to follow the simplified liquidation process if the liquidator believes on reasonable grounds that the company (or a director) has engaged in conduct involving fraud or dishonesty and the conduct has had, or is likely to have, a material adverse effect on the interests of the creditors as a whole or a class of creditors as a whole.[183]

6.3.18 Assetless companies

ASIC administers a small Assetless Administration Fund, the purpose of which is to finance preliminary investigations and reports to ASIC by liquidators into the failure of companies with few or no assets, to assist ASIC in deciding whether to commence enforcement action, usually against directors. A particular focus of the Fund is to curb fraudulent phoenix activity.

Self-Assessment Exercise 4

Question 1

To what extent is a company's insolvency a pre-requisite for corporate liquidation in Australia?

Question 2

What avenues are available for a liquidator to recover property from third parties to expand the pool available for distribution to creditors? What are the practical limitations, if any, of those avenues?

[183] Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020, reg 5.5.07(1).

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6.4 Receivership

6.4.1 Introduction

In Australia, receivership continues to be an important form of external administration. This can be contrasted with the position in the United Kingdom, where administrative receivership has been abolished, with limited exceptions.[184]

Most receivers are privately appointed pursuant to a contractual right in relation to a security interest. Private receivership is not a collective insolvency process. Rather, it is a private process for enforcement of the secured creditor's rights. Whilst the right to appoint the receiver is a contractual one, some aspects of the receiver's conduct and powers, and the interaction between receivership and other forms of external administration, are provided for in the Corporations Act.[185]

Occasionally, a court will appoint a receiver, typically where it is necessary to preserve or realise property pending the resolution of an underlying dispute, or where the body that owns the asset is not capable of being liquidated. Court-appointed receivers are rarely appointed and their appointment is not dependent on insolvency. Accordingly, they will not be further considered in this Module. A reference to a "receiver" should hereafter be understood to mean a privately-appointed receiver.

While a receiver can be appointed over the assets of an individual or a company, receivership most commonly arises in practice in the corporate insolvency sphere. The focus in this section is accordingly on corporate receivership.

6.4.2 Appointment

In practice, a receiver is usually appointed by a creditor who has a security interest over the whole, or substantially the whole, of a company's property. The right of a secured creditor to appoint a receiver in that scenario can be enforced even if a liquidator or voluntary administrator has been previously appointed to a company (subject to the appointment occurring within a prescribed time period in the case of voluntary administration, discussed in paragraph 6.5.2.4 below).

The receiver is entitled to act "over the top" of the liquidator or voluntary administrator and realise the assets of the company which are subject to the relevant security interest before distributing the proceeds to the secured creditor (subject to first paying certain priority amounts

[184] Insolvency Act 1986 (UK), s 72A.
[185] Corporations Act, Pt 5.2 (ss 416 - 434M).

to the extent the security interest is circulating, discussed in paragraph 6.4.3 below). This is a common occurrence in practice.

A secured creditor's right to appoint a receiver will only arise if it is expressly provided for in the relevant security documents. Australian courts do not recognise an implied right to appoint a receiver.[186] Even where there is an express right to appoint a receiver, that right can only be enforced if the security interest is valid (regarding which, see the discussion at 5.3 above regarding the ways in which a security interest may be invalidated when a company enters voluntary administration or liquidation).

There was previously a technical distinction between receivers, who merely receive and distribute the income from the property over which they are appointed, and receivers and managers, who are entitled to carry on a company's business and buy and sell assets on behalf of the company. However, the Corporations Act now expressly gives receivers and receivers and managers the same powers[187] so the distinction between the two offices is no longer of any practical relevance.

6.4.3 Role of a receiver and course of the receivership

The security agreement pursuant to which a receiver is appointed almost always provides that the receiver is the agent of the company and not the agent of the secured creditor. The receiver's agency ends if a liquidator is later appointed while the receiver is still acting.[188] From that point onwards, the receiver is the agent of the secured creditor, despite what is provided for in the security agreement.

Regardless of whether the receiver is acting as agent for the company or the secured creditor, the receiver's primary duty is always to the secured creditor.[189] The duty of a receiver towards the company and later-ranking secured creditors and unsecured creditors is limited to acting in good faith and not recklessly sacrificing their interests.[190] However, there is an express statutory duty in the Corporations Act for a receiver to take all reasonable care to sell property for no less than its market value or, if there is no market value, for the best price reasonably obtainable.[191]

If the secured creditor's security includes a circulating security interest, the receiver is required to first apply the proceeds from the sale of the circulating assets to meet the priority claims of the company's employees.[192] Only if there is a balance remaining after the payment of those priority amounts can the receiver distribute the proceeds from realised circulating assets to the secured creditor.

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[186] *Canberra Advance Bank Ltd v Benny* (1992) 38 FCR 427.
[187] Corporations Act, s 420.
[188] *Idem*, s 420C.
[189] *Expo International Pty Ltd v Chant* [1979] 2 NSWLR 820, 831-832.
[190] *Idem,* 833-836.
[191] Corporations Act, s 420A.
[192] *Idem*, s 433.

If, notwithstanding the existence of prioritised security interests such as PMSIs, the receiver wishes to sell the company's property as a going concern to achieve a more favourable price in the interests of not only the appointing secured creditor but all of the company's creditors, the receiver is entitled to apply to the court for approval of the sale.[193] Before making an order, the court must be satisfied, among other things, that:

- the receiver has sought the consent of the first-ranking secured party and the first-ranking secured party has refused to give their consent;
- sale of the property on a going concern basis is in the best interests of all creditors; and
- the first-ranking secured party will be adequately protected, for example by the retention of sale proceeds attributable to the first-ranking security being held in a separate bank account for the benefit of the secured party.[194]

If a receiver sells property subject to a first-ranking security without the consent of the first-ranking secured party or the approval of the court, the receiver may be personally liable for having wrongly dealt with the property.[195]

Where the security under which a receiver is appointed operates over the whole or substantially the whole of a company's property, a receiver might elect to continue to operate the company's business for a time, usually pending a sale of the business as a going concern. In that event, the *ipso facto* moratorium which applies during voluntary administration (see paragraph 6.5.2.5 below) also applies during the period of receivership.[196] The moratorium enhances the prospect of a going concern sale without the pressure of key suppliers and creditors terminating their contracts with the company and leaving the company without a viable business.

If a receiver elects to perform a pre-appointment contract executed by the company, including by retaining the services of existing employees, the receiver will not be personally liable under the contract unless they expressly adopt it.[197] For debts incurred under new contracts entered into after the commencement of the receivership, the receiver is *prima facie* deemed to be personally liable for the debts.[198] However, by virtue of the receiver's agency, the receiver will have a right to be indemnified from the assets of the company for that liability, supported by an equitable lien.[199] This is co-extensive with the position of a voluntary administrator, discussed in paragraph 6.5.2.5 below.

Once a receiver has realised the property subject to the appointing creditor's security interest and distributed the proceeds to the secured creditor (after the payment of any priority amounts to the extent the security operates over circulating assets), the receiver will retire from office and

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193 *Idem*, s 420B.
194 *Idem*, s 420B(2).
195 The liability being for the tort of conversion.
196 Corporations Act, s 434J.
197 *Re British Investments & Development Co Pty Ltd* (1979) ACLC 32,100.
198 Corporations Act, s 419(1).
199 *James v Commonwealth Bank of Australia* (1992) 37 FCR 445.

hand any surplus funds back to the company or, if a voluntary administrator, liquidator or deed administrator has also been appointed, to that external administrator.

6.5 Corporate rescue

6.5.1 Types and availability of formal corporate rescue

There are three types of formal corporate rescue in Australia:

- voluntary administration, followed by the implementation of a DOCA (deed of company arrangement) under Part 5.3A of the Corporations Act;
- a creditors' scheme of arrangement under Part 5.1 of the Corporations Act; or
- for companies with liabilities of less than AUD 1 million, a restructuring process and restructuring plan under the new Part 5.3B of the Corporations Act which came into effect on 1 January 2021.

These corporate rescue mechanisms are limited to companies registered under the Corporations Act. These mechanisms are not available to persons conducting business in a sole trader or partnership capacity, who would instead need to look to the personal insolvency agreement or debt agreement mechanisms under the Bankruptcy Act (see paragraph 6.2.4 above).

Voluntary administration is the dominant type of formal corporate rescue in Australia. Despite increased uptake in larger, more complex insolvencies in recent years, creditors' schemes of arrangement remain relatively rare in practice. Creditors' schemes of arrangement are almost identical to creditors' schemes of arrangement in England. Accordingly, the majority of the discussion in the remainder of this paragraph (paragraph 6.5) will be devoted to voluntary administration, DOCAs and the new small company restructuring process.

6.5.2 Voluntary administration

6.5.2.1 Purpose of voluntary administration

The express statutory objective of voluntary administration is for an insolvent company's affairs to be administered in a way that:

- maximises the chance of the company, or as much as possible of its business, continuing in existence; or
- otherwise will produce a better return for the company's creditors and members than an immediate liquidation of the company.[200]

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[200] Corporations Act, s 435A.

Accordingly, voluntary administration is not exclusively a corporate rescue process in Australia. In practice, it is more commonly resorted to as a mechanism to achieve business rescue via a going concern sale of the company's business to another entity. In either case, the legislative policy is for the interests of a broad range of stakeholders, including employees, suppliers and the economy more broadly, to be served by the maintenance of a corporate entity or at least its business where it is viable and economically efficient for that to occur.[201]

In an important recent decision, the High Court of Australia emphasised the primary intended use of voluntary administration to achieve corporate or business rescue, approving a "holding DOCA" underpinned by an ongoing moratorium on the enforcement of creditors' claims and no interim distribution of dividends to creditors while the deed administrator pursued means of saving the company or achieving a going concern sale of its business.[202]

Note that, like in a US Chapter 11, and unlike an Australian or UK scheme of arrangement, in a voluntary administration, the DOCA restructuring proposal does not have to be ready at the time the company enters voluntary administration. This allows the company the benefit of the voluntary administration moratorium while a DOCA proposal is being prepared. Normally, DOCA proposals are made by the directors or shareholders of the company to the voluntary administrator. The voluntary administrator is then expected to take a pro-active role in negotiating the proposed terms, so that a DOCA proposal can be put to creditors which the voluntary administrator is willing to recommend they accept. A DOCA may also be used as a mechanism for the sale of the company's business as a going concern. That type of DOCA will usually be prepared by the voluntary administrator after they have identified a purchaser for the business.

If neither corporate rescue nor business rescue are possible, the Corporations Act contemplates that voluntary administration may still be used purely as a means to maximise the monetary return available to the company's outstanding creditors.

Voluntary administration is not a stand-alone form of external administration in Australia. Rather, it operates as a precursor to the company either executing and implementing a DOCA or otherwise being returned to its directors or proceeding to immediate liquidation. Which outcome takes place depends on the decision reached by creditors at a meeting called by the voluntary administrator (discussed in paragraph 6.5.2.6 below).

In contrast to a creditors' scheme of arrangement (see paragraph 6.5.3 below), it is possible for voluntary administration and the implementation of a DOCA to take place without any court involvement.

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[201] *Sydney Land Corp Pty Ltd v Kalon Pty Ltd* (1997) 26 ACSR 427, 430.
[202] *Mighty River International Ltd v Hughes* (2018) 265 CLR 480.

6.5.2.2 Appointment of a voluntary administrator

A voluntary administrator may be appointed by:

- a majority of the company's directors after resolving that, in their opinion, the company is insolvent or is likely to become insolvent at some future time and that an administrator should be appointed[203] – in practice, this is by far the most common way for an appointment to occur;
- a liquidator or provisional liquidator of the company may appoint a voluntary administrator in writing if they think that the company is insolvent, or is likely to become insolvent at some future time[204] – this may occur where the liquidator or provisional liquidator originally appointed to the company forms the view that there is a real prospect of the company or business continuing in existence through a DOCA, or of a going concern sale that will be best achieved with the benefit of the more extensive enforcement moratorium that applies during voluntary administration; or
- a creditor with a security interest over the whole, or substantially the whole, of the company's property can appoint a voluntary administrator if the security interest has become enforceable[205] – in this scenario, the relevant secured creditor (typically a bank or other large financier) can choose to appoint a voluntary administrator instead of a receiver. This is not common in practice.

6.5.2.3 Role of voluntary administrator and process of the administration

Upon assuming office, a voluntary administrator takes full control of the company's business, property and affairs and is entitled to perform any function or exercise any power on behalf of the company, including carrying on the company's business or disposing of its assets.[206] For the period of the voluntary administrator's appointment, directors of the company remain in office but their powers are suspended.[207]

While a voluntary administrator's powers are broad, they are intended to be exercised only for the specific purpose of the administrator investigating the affairs of the company and issuing a recommendation to creditors as to how they should vote on the company's future.[208] It is generally prudent for an administrator to maintain the asset position of the company (at least in relation to the company's major assets and undertaking), leaving any proposed sale to be approved by creditors at the second meeting of creditors unless there is no prospect of an alternative purchaser at a later time and the sale would be beneficial to unsecured creditors.[209]

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[203] Corporations Act, s 436A.
[204] *Idem*, s 436B.
[205] *Idem*, s 436C.
[206] *Idem*, s 437A(1).
[207] *Idem*, s 198G(1).
[208] *Tolcher v National Australia Bank* (2004) 182 FLR 419.
[209] *Re Eisa Ltd* (2000) 35 ACSR 394.

If an administrator does elect to deal with the company's assets prior to the second meeting of creditors, they are given an important power under the Corporations Act to dispose of assets that are subject to a valid security interest (or that are otherwise subject to the rights of an owner or lessor under an arrangement which does not qualify as a security interest, charge, lien or pledge), provided:

- the voluntary administrator obtains the consent of the secured party, owner or lessor or the court; or
- the disposal is otherwise in the ordinary course of the company's business and the interests of the secured party, owner or lessor would be adequately protected, for example where the voluntary administrator agrees to set aside the sale proceeds in a separate bank account for the benefit of the secured party, owner or lessor.[210]

In dealing with the company's creditors, the first task of the voluntary administrator is to convene and hold a first meeting of creditors within eight business days of their appointment, at which time creditors' power is limited to resolving to:

- remove and replace the administrator; and / or
- appoint a committee of inspection to represent the interests of all creditors in their dealings with the administrator.[211]

Subsequently, the voluntary administrator must convene and hold a second meeting of creditors within 25 business days of being appointed (although the creditors can resolve to adjourn the meeting for up to 45 days and the court can extend this period where an extension is warranted).[212]

At the time of convening the second meeting of creditors, the voluntary administrator must send creditors:

- a report about the company's business, property, affairs and financial circumstances;[213] and
- a statement setting out various matters, including:
    - the administrator's opinion, with supporting reasons, on whether it would be in creditors' interests for the company to be returned to directors, for a DOCA to be executed or for the company to be immediately placed in liquidation;[214] and

[210] Corporations Act, s 442C.
[211] *Idem*, s 436E.
[212] *Idem*, s 439A.
[213] IPRC, r 75-225(3)(a).
[214] *Idem*, rr 75-225(3)(b)(i)-75-225(3)(b)(iv).

- whether there have been any dispositions of the company's property which may be recovered under the voidable transaction provisions of the Corporations Act (discussed in paragraph 6.3.14 above).

If the voluntary administrator recommends that creditors approve the execution of a DOCA, the material terms of the DOCA must be set out as part of the statement to creditors.[215]

To ensure they are in a position to be able to provide the required report and statement to creditors, the voluntary administrator must conduct appropriate investigations of the company's affairs immediately after being appointed. To assist the voluntary administrator in those investigations, directors of the company are required to give the administrator a report as to the affairs of the company and to otherwise assist the administrator as required.[216]

In light of the timing restrictions for calling the second meeting of creditors and the temporary, "precursory" nature of voluntary administration as a form of external administration, Australian courts have said that a voluntary administrator's investigations are intended to be swift and practical.[217] The investigations should be thorough but it is simply not possible for the investigations to be as comprehensive as those conducted by a liquidator.[218] As with a liquidator, a voluntary administrator must also act with independence and impartiality, with the appearance of conflict just as important as an actual conflict in justifying the removal of an administrator from office.[219]

A voluntary administrator's advice to creditors on the likelihood of recoveries under the voidable transaction provisions or insolvent trading provisions of the Corporations Act is particularly significant as recovery proceedings under those provisions can only be pursued in a liquidation.[220] Accordingly, if there is a prospect of significant recoveries, it may be in the best interests of creditors to place the company into a creditors' voluntary liquidation rather than resolving for a DOCA to be executed.

6.5.2.4 Scope of moratorium during voluntary administration

Prima facie, except with the consent of the voluntary administrator or the leave of the court, all creditors, both secured and unsecured, cannot enforce their rights during voluntary administration.[221]

However, there are exceptions to the statutory moratorium for:

- a creditor with a security interest over the whole, or substantially the whole, of a company's property – in that case, the creditor can enforce its security interest, typically by appointing a receiver, within the "decision period" of 13 business days from the commencement of the

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[215] *Idem*, r 75-225(3)(vii).
[216] Corporations Act, s 438B.
[217] *Cresvale Far East v Cresvale Securities* (2001) 37 ACSR 394, 421.
[218] *Re TEN Network Holdings Limited (admins apptd) (recs and mgrs apptd)* [2017] NSWSC 1247.
[219] *Commonwealth Bank of Australia v Fernandez* (2010) 81 ACSR 262.
[220] Corporations Act, ss 588FE, 588FF, 588M.
[221] *Idem*, ss 440B, 440F.

voluntary administration or from the secured party receiving notice of the appointment of the voluntary administrator;[222] and

- subject to a contrary order of the court,[223] a secured creditor, or an owner or lessor, that seeks to either continue with enforcement action commenced prior to the appointment of the voluntary administrator[224] or to otherwise recover perishable property.[225]

Additionally, unlike in other forms of external administration, the liability of a director (or spouse or relative of a director) who has provided a guarantee in favour of the company cannot be enforced during voluntary administration without the leave of the court.[226] This is intended to provide an incentive for directors to appoint a voluntary administrator rather than proceeding to immediate liquidation.

6.5.2.5 The impact of voluntary administration on contracts and the liability of the administrator under new contracts

Repudiation of pre-appointment contracts at the election of the voluntary administrator

Upon appointment, a voluntary administrator must determine which contracts of the company should be maintained. Although an administrator is not, unlike a liquidator, authorised to disclaim pre-appointment contracts entered into by the company, the administrator can nevertheless cause the company to repudiate pre-appointment contracts. In the event of repudiation, the counter-party to the contract will not have a personal claim against the administrator but rather will be left to lodge a proof of debt in any subsequent liquidation or deed administration of the company for damages for breach of contract.

Maintenance of pre-appointment contracts

If a voluntary administrator forms the view that a company may be resuscitated, or that there is a prospect of the company's business being sold on a going concern basis, it will be necessary for the administrator to continue trading pending the second meeting of creditors.

In that event, if the administrator elects to continue a pre-appointment contract, the administrator will generally not be personally liable for the debts which arise under the contract unless they expressly adopt the contract (co-extensive with the position of a receiver, discussed in paragraph 6.4.3 above). This includes ongoing wages of employees originally engaged by the company before the commencement of the voluntary administration and who are then retained by the administrator.[227]

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[222] *Idem*, ss 9, 441A.
[223] *Idem*, ss 441D, 441H.
[224] *Idem*, ss 441B, 441F.
[225] *Idem*, ss 441C, 441G.
[226] *Idem*, s 440J.
[227] *McEvoy v Incat Tasmania Pty Ltd* (2003) 46 ACSR 392. A similar conclusion was reached in relation to the supply of electricity under a pre-appointment contract in *AGL Victoria Pty Ltd v Lockwood* [2003] VSC 453.

Ipso facto *moratorium*

Significantly, where a voluntary administrator wishes to maintain a pre-appointment contract, they will now be assisted by a statutory moratorium on the enforcement of *ipso facto* contractual rights by creditors.

For contracts entered into with a company on or after 1 July 2018, where a company is in the process of voluntary administration (but not administration under a DOCA unless the court orders otherwise), a creditor is now prevented from relying on an *ipso facto* contractual clause to terminate a contract with the company solely because the company has entered voluntary administration or because of the company's general financial position while it remains in voluntary administration,[228] subject to the creditor obtaining a court order permitting enforcement where it is in the interests of justice.[229]

However, the *ipso facto* moratorium will not apply where a creditor seeks to enforce a contractual right on the independent basis that a company has not complied with a payment or performance obligation after it enters voluntary administration. But in that case, it is open to the administrator to apply to the court to extend the moratorium on the basis that the real reason for the creditor enforcing its rights is the fact that the company has entered voluntary administration, or otherwise that the company is experiencing adverse financial circumstances more generally during the administration.[230]

There are specific exceptions to the *ipso facto* moratorium where the contract or arrangement under which the *ipso facto* rights arise is of a certain type, such as:

- a derivatives contract;
- a contract related to securities, securities financing, financial products, bonds, promissory notes or syndicated loans;
- an underwriting contract;
- a business or share sale agreement;
- a factoring arrangement; or
- some building and construction contracts.[231]

There are also exceptions to the moratorium where the right sought to be enforced by a creditor is of a certain type, such as:

- a right to charge default interest;

[228] Corporations Act, s 451E.
[229] *Idem*, s 451F.
[230] *Idem*, ss 415F, 434L, 451G.
[231] Corporations Regulations, reg 5.3A.50(2).

- a termination right in a standstill or forbearance agreement;
- a right of set-off or combination of accounts;
- a right to net balances or other amounts;
- a right of assignment or novation;
- step-in rights to perform obligations under a contract; or
- the appointment of a receiver by a first-ranking secured creditor.[232]

The *ipso facto* moratorium applies not only in voluntary administrations, but also in in the following types of insolvency proceedings:

- a creditors' scheme of arrangement (including certain steps leading up to the scheme);
- a receivership but only where the receiver is appointed over the whole or substantially the whole of the property of the company; or
- a small company restructuring.

Entry into new contracts

In contrast to the position where a voluntary administrator continues a pre-appointment contract, for new contracts entered into by the voluntary administrator, such as the engagement of new employees, a new contract for the supply of goods or services or a new financing facility, the administrator is deemed to be personally liable for the debts incurred under the relevant contracts.[233]

The policy basis for administrators' personal liability is to encourage suppliers and other creditors to continue to deal with the company after it has entered voluntary administration (being assured of payment by the voluntary administrator even if the company has insufficient assets), thereby maximising the prospect of corporate or business rescue which both depend on the support of key financiers and suppliers.

A voluntary administrator has a right of indemnity out of the company's free assets to discharge their personal liability for the debts incurred under new contracts, which is supported by a statutory lien over the company's assets.[234] The payment of the debts under the right of indemnity will have first priority over other unsecured claims so long as the debts have been properly incurred in preserving, realising or collecting the company's property or in otherwise conducting the company's business.

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[232] Corporations (Stay on Enforcing Certain Rights) Declaration 2018 (Cth), rr 5(4), 6.
[233] Corporations Act, 443A(1).
[234] *Idem*, ss 443D, 443F.

Where a company has insufficient free assets, a voluntary administrator can apply to the court under section 447A of the Corporations Act for an order limiting the administrator's liability to the value of the company's free assets (essentially overriding the administrator's deemed personal liability). However, the success of the application would depend on the consent of the counterparty to the contract.[235] If a creditor is not "over-secured" (that is, the value of the property secured does not exceed the value of the company's existing indebtedness) or there is not otherwise a good prospect of the company being able to trade out of its financial difficulties, consent is unlikely to be forthcoming. Unlike in the United States, there is no provision for an administrator to seek court approval to grant a new lender "super priority" under a priming lien over existing secured creditors in return for "debtor-in-possession financing".

6.5.2.6 Voting by creditors

At the second meeting of creditors, there are three options for creditors:

- resolve for the company to execute and implement a DOCA in the terms set out in the voluntary administrator's statement to creditors;
- resolve that the administration should end and the company should return to the control of its directors; or
- resolve that the company should be wound up.[236]

The resolution of creditors will be passed if it receives the support of the majority of creditors present and voting at the meeting and the value of the debts owed to those creditors is more than half of the total debts owed to all creditors present and voting.[237] If no result is reached on a resolution, the voluntary administrator is entitled to exercise the casting vote at the meeting.[238]

For the purpose of voting, creditors are not, in contrast to when they vote on whether to approve a creditors' scheme of arrangement (see paragraph 6.5.3 below), divided into separate classes.

Significantly, secured creditors are entitled to vote for the full amount of their debts at the second meeting of creditors. Unlike during liquidation, secured creditors' voting rights are not conditional on the surrender of their security or creditors voting only in relation to the balance owing to them after deducting the value of their security.[239] This is designed to encourage secured creditors to participate in the voluntary administration process rather than enforcing their rights (to the extent they are able to remain outside the statutory moratorium).

[235] *Re Preston* [2016] FCA 1175.
[236] Corporations Act, s 439C.
[237] IPRC, r 75-115(1).
[238] *Idem*, r 75-115(3).
[239] *Idem*, r 75-87.

6.5.2.7 Content of a DOCA

If creditors resolve for a DOCA to be entered into at the second meeting of creditors, the DOCA must then be executed within 15 business days after the meeting ends (subject to any extension of time granted by the court).[240] Upon execution, the voluntary administration ends and the DOCA becomes effective.[241]

A DOCA can cover a wide range of matters. At a minimum, it is required to identify:

- the person proposed to administer the DOCA (the "deed administrator", who will generally be the voluntary administrator continuing in office);
- the scope of the property available to meet creditors' claims;
- the terms of the moratorium on the enforcement of creditors' claims proposed to apply while the DOCA is administered;
- the process for realising the company's property;
- the extent to which the company will be released from any of its debts – in that regard, a DOCA will typically include detailed provisions dealing with the restructure and / or compromise of creditors' claims;
- the order in which realised proceeds will be applied to meet creditors' claims; and
- the circumstances in which the DOCA will terminate.[242]

Unless the DOCA specifically provides otherwise, it will be taken to include the prescribed provisions set out in the Corporations Regulations, such as the requirement for realised funds to be distributed in accordance with the statutory priority regime which applies when a company is being liquidated.[243]

Following amendments to the Corporations Act in 2007, it is now possible for a DOCA to be used to effect a transfer of shares in support of a debt for equity swap.[244] The amendment was designed to increase the flexibility of DOCAs and enhance the likelihood of a successful restructuring attempt with the support of major banks and other financiers, to whom an equity interest in the company may be an attractive proposition where there is a reasonable prospect of the company being able to trade out of its financial difficulties.

While, as a whole, a DOCA is a flexible document which can deal with broad circumstances unique to the financial difficulties a particular company is experiencing, the High Court of

[240] Corporations Act, s 444B(2).
[241] *Idem*, s 435C(2)(a).
[242] *Idem*, s 444A(4).
[243] Corporations Regulations, reg 5.3A.06, sch 8A.
[244] Corporations Act, s 444GA.

Australia has confirmed that, unlike a creditors' scheme of arrangement, it is not possible for a DOCA to seek to bind parties other than the insolvent company and its creditors, for example by including releases of creditors' claims against third party related entities of the insolvent company.[245]

6.5.2.8 Impact of a DOCA

If creditors have resolved for a DOCA to be executed, directors' powers will revive when the voluntary administration ends and the DOCA becomes effective, subject to any specific restrictions contained in the DOCA.

A DOCA is binding on all creditors to the extent their claims arose on or before the time nominated in the DOCA (usually specified as the date of the voluntary administrator's appointment).[246] The courts have said that the term "creditor" for that purpose includes all persons that have a claim against the company based on circumstances which occurred before the appointment of the voluntary administrator, meaning that there is no need for a debt to in fact be presently due and payable by that time.[247] Accordingly, guarantors, as contingent creditors of the company, are bound by a DOCA,[248] as are lessors in relation to the right to receive future rent from the company pursuant to the terms of a lease in existence when a voluntary administrator was appointed.[249]

However, there is a carve-out in the Corporations Act so that a DOCA will only be binding on secured creditors[250] if they either voted in favour of the DOCA or the court so orders. Accordingly, the success of a DOCA and the ultimate utility of voluntary administration as an effective form of corporate or business rescue, depends in large part on the support of a company's major banks and other key financiers and suppliers.

The court's residual discretion to restrict a secured creditor (or other owner or lessor) from enforcing its interest even if it did not vote in favour of the DOCA is intended to prevent such a party from "holding out" and derailing a rescue attempt for a company or business which is genuinely viable. The court's discretion is broadly equivalent to the United States bankruptcy "cramdown" procedure. As in the United States, the court can only make an order preventing a creditor from enforcing its interest if, in addition to enforcement having a material adverse effect on the prospect of a successful corporate or business rescue, the relevant secured creditor (or other owner or lessor) would be adequately protected under the terms of the DOCA,[251] for example by receiving compensation to cover opportunity cost and any decline in the value of the secured property while a moratorium is in place.

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[245] *Lehman Brothers Holdings Inc v City of Swan* (2010) 240 CLR 509.
[246] Corporations Act, s 444A(4)(i).
[247] *Brash Holdings Ltd v Katile Pty Ltd* [1996] 1 VR 24.
[248] *Re Zambena Pty Ltd* (1995) 13 ACLC 1020.
[249] *Lam Soon Australia Pty Ltd v Molit (No 55) Pty Ltd* (1996) 70 FCR 34.
[250] Corporations Act, s 444D(2).
[251] Corporations Act, ss 444F(2), 444F(4).

6.5.2.9 Proofs of debt

All creditors bound by a DOCA are entitled to submit a proof of debt to the deed administrator for the purpose of receiving a distribution of funds during the implementation of the DOCA. The process for submitting proofs of debt, and the deed administrator's determination to approve or reject a proof of debt (in whole or part), is similar to the process which applies during bankruptcy and liquidation (see paragraphs 6.2.3.8 and 6.3.10 above).

6.5.2.10 Set-off

One of the prescribed provisions taken to be included in a DOCA unless otherwise excluded is the insolvency set-off provision (see paragraph 6.3.11 above). If a DOCA seeks to exclude the right of set-off, a creditor may have a basis to apply to the court for the DOCA to be set aside as being unfairly discriminatory or prejudicial.[252]

6.5.2.11 Priority of payment under a DOCA

As noted in paragraph 6.5.2.7 above, one of the prescribed provisions of a DOCA is that, unless the DOCA specifically provides otherwise, the property realised by a deed administrator must be applied to meet the claims of creditors in the same manner as if the company was being liquidated, including by paying priority creditors in the order specified by section 556 of the Corporations Act.

If a DOCA seeks to vary the order of statutory priorities and the DOCA is approved at the second meeting of creditors notwithstanding the opposition of the priority creditors prejudiced by the variation, those creditors will have a strong basis to apply to the court to have the DOCA set aside on the ground that it is unfairly discriminatory or prejudicial.[253] Further, employees, as one class of priority creditors, are given specific statutory protection, with section 444DA of the Corporations Act expressly requiring the priority of employee entitlements to be maintained unless employees agree to the contrary. This is designed to prevent employees having to go to the expense of a court application challenging a DOCA if their statutory priority has been displaced.

Provided the statutory order of priorities is maintained, a DOCA can differentiate between other classes of creditors without being considered unfairly discriminatory or prejudicial if the differentiation has a legitimate business rationale, for example where it is necessary to secure the support of a key financier, supplier or lessor for the company to be able to continue to trade (in circumstances where the financier, supplier or lessor could otherwise choose to vote against the DOCA and enforce its claim outside the terms of the DOCA).[254]

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[252] Corporations Act, s 445D(1)(f)(i); *Re Lindholm; Opes Prime Stockbroking Ltd (admin apptd) (recs and mgrs. apptd)* (2008) 68 ACSR 88, 93.
[253] Corporations Act, s 445D(1)(f)(i).
[254] *Hayes v Doran (No 2)* [2012] WASC 486.

6.5.2.12 Pooling

In Australia, there is no formal statutory mechanism for the assets and liabilities of different insolvent companies within a corporate group to be pooled together for the purpose of implementing a restructuring under a DOCA. However, pooling can be achieved in practice where the assets and liabilities of all insolvent group entities are transferred to the entity which executes a DOCA.[255] If the pooling of assets and liabilities is approved by creditors of the different companies involved in the pooled arrangement, it can then be implemented under the DOCA subject to any application by an aggrieved creditor alleging that the terms of the DOCA are oppressive or unfairly prejudicial.

6.5.2.13 Conversion to liquidation

There are several means by which a company subject to the control of a voluntary administrator or the administrator of a DOCA may proceed to liquidation:

- where creditors resolve at the second meeting of creditors to place the company in liquidation; or
- where, although creditors have resolved for a DOCA to be executed at the second meeting of creditors:
  - the DOCA is not executed by the required time (see paragraph 6.5.2.7 above);
  - creditors subsequently resolve to terminate the DOCA; or
  - the court subsequently sets aside the DOCA, for example on the basis that it is false or misleading, oppressive or unfairly prejudicial to one or more creditors or is contrary to the interests of creditors as a whole.

In each case, the liquidation will proceed in that event as a creditors' voluntary liquidation.[256]

The court's broad power to terminate a DOCA on the application of any creditor is one of the disadvantages of a DOCA.[257] Where certainty is required in a large and complex restructuring, this can be a serious drawback. A scheme of arrangement, by contrast, will rarely be terminated by a court as the court's approval is sought before the scheme is put to creditors.

6.5.3 Creditors' scheme of arrangement

Under the scheme of arrangement procedure in the Corporations Act, directors of a financially distressed company, generally prior to the onset of formal insolvency, enter into negotiations with the company's creditors in an effort to secure their support for a formal restructure of the company's debts and existing operations.

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[255] *Mentha v GE Capital Ltd* (1997) 27 ACSR 696.
[256] Corporations Act, ss 446A, 446AA.
[257] *Idem*, s 445D.

There are certain prescribed matters which must be specifically disclosed to creditors in a proposed scheme document, including creditors' expected dividends under the scheme compared to a winding up, the extent and amount of creditors' claims and comprehensive information about the company's financial and other affairs.[258]

If it appears to directors that there is a good level of support for the proposed scheme, particularly from major secured creditors and other key financiers and suppliers, the directors will then cause the company to make an initial application to the court for an order convening a meeting of all creditors to consider whether to approve the scheme. If creditors are proposed to be treated in fundamentally different ways under the scheme (for example, where some creditors receive preferential treatment in the payment of their claims even though they are not secured and would not otherwise be entitled to priority in a liquidation), the court will require separate meetings of different classes of creditors to be convened.[259]

Significantly, if the court orders a meeting of creditors to be convened, a resolution approving the scheme at the meeting subsequently held requires the support of:

- a majority of creditors in fact present and voting at the meeting (whether in person or by proxy, attorney or corporate representative); and

- 75 per cent of the total amount of the debts and claims of creditors present and voting at the meeting.[260]

Those voting conditions apply to each separate class if multiple meetings of different classes of creditors are required, so that a scheme cannot proceed unless all classes of creditors vote in favour of it by the required majorities.

If the scheme is approved, a second court application is then required for the court to formally approve the scheme. The court will generally do so if there has been full disclosure of all material matters concerning the scheme to creditors, the meeting or meetings of creditors have been properly convened and there is no clear circumstance of unfairness or injustice (on the basis that the court considers creditors to be better judges of their own commercial interests than the court).[261]

If court approval is obtained, the scheme will be implemented in accordance with the specific terms of the scheme document, including by paying out creditors over time and completing the terms of any restructured debt facilities provided for in the scheme. An administrator of the scheme is not specifically required by the Corporations Act or by ASIC, although it will often be appropriate for an administrator to be appointed if the implementation of the scheme will occur over a protracted period.

[258] Corporations Regulations, sch 8, prt 2.
[259] *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.
[260] Corporations Act, s 411(4)(a)(i).
[261] *Re Centro Properties Ltd* [2011] NSWSC 1465; *Re CSR Ltd* (2010) 183 FCR 358.

Significantly, the moratorium on the enforcement of *ipso facto* rights under contracts entered into with a company on or after 1 July 2018 that applies during voluntary administration (see paragraph 6.5.2.5 above) also applies, with the same exclusions, while a creditors' scheme of arrangement is negotiated and implemented.[262] This enhances the prospect of a scheme being effectively used as a corporate or business rescue mechanism which is binding on all creditors, notwithstanding the dissent of minority creditors.

A creditors' scheme of arrangement is a complex and costly process given the requirement for two court applications (and possibly more if material circumstances arise which need to be brought to the attention of the court). In contrast, the voluntary administration / DOCA process does not require court approval and indeed may not involve the court at all if a voluntary or deed administrator does not apply to the court to seek directions at any stage and no creditors approach the court to challenge the conduct of the administrator or the terms of the DOCA.

The added complexity of a creditors' scheme of arrangement means that it will take a minimum of three months to be fully implemented, although in practice a time period of six months or more for implementation is not uncommon. On the other hand, it is possible for a DOCA to be completed fairly quickly after the 25 to 30 business day voluntary administration period, depending on the nature of the arrangements proposed by the DOCA.

Nevertheless, a creditors' scheme of arrangement offers two significant advantages which cannot be achieved under a DOCA:

- it can bind dissenting secured creditors (provided the statutory voting majorities are met, which is not easy to achieve in practice);[263] and

- it can include the release of creditors' rights against third parties other than the company.[264]

Those advantages permit a more novel and wide-ranging corporate restructure to be implemented under a creditors' scheme of arrangement than that available under a DOCA. For that reason, and particularly in light of the increasing complexity of corporate and financial arrangements in general following the global financial crisis, there has been a greater uptake of creditors' schemes of arrangement in more recent years, with schemes used to effect some of Australia's largest and most high-profile corporate restructurings including Boart Longyear, Atlas Iron, Nine Entertainment Group, Lehman Brothers Australia, Centro Group, Opes Prime Group and Alinta Limited. It may be that, in future years, the growth trend in creditors' schemes of arrangement will continue.

[262] Corporations Act, s 415D(1).
[263] *Re Nine Entertainment Group Ltd (No 1)* (2012) 211 FCR 439.
[264] *Fowler v Lindholm; Re Opes Prime Stockbroking Ltd* (2009) 74 ACSR 124.

6.5.4 New small company restructuring process

6.5.4.1 Background and purpose

The Australian Government has introduced a new restructuring process to enable financially distressed small companies to restructure their existing debts. This new process is in Part 5.4B of the Corporations Act, immediately after the existing voluntary administration and DOCA regime in part 5.4A. Although the new process draws heavily on the established voluntary administration framework, it is intended to operate as an alternative to the costly and lengthy "one-size-fits-all" voluntary administration regime.

The object of the restructuring process is for companies to retain control of their business, property and affairs while developing (with the assistance of a restructuring practitioner) a restructuring plan[265] setting out an approach to repay the company's existing debts, so as to enable the company to continue as a going concern. Creditors can vote to accept or reject that plan.[266]

6.5.4.2 Eligibility criteria for the restructuring process

To be eligible for the restructuring process, the following must be satisfied on the day that a restructuring practitioner is appointed for the company:[267]

- the company's total liabilities do not exceed AUD 1 million;[268]
- no current director of the company (or a former director in the last 12 months) has been a director of another company that has been under restructuring or the subject of a simplified liquidation process within seven years;[269] and
- the company has not itself been under restructuring or the subject of a simplified liquidation process within 7 years.[270]

As with the simplified liquidation process, the last two criteria safeguard against illegal phoenixing activity or other forms of corporate misconduct.[271]

6.5.4.3 Appointment of a restructuring practitioner

A company that satisfies the above eligibility criteria may appoint a restructuring practitioner (who must be an independent registered liquidator)[272] if the board has resolved that, in the

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265 Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 452A(a).
266 Explanatory Memorandum to the Corporations Amendment (Corporate Insolvency Reforms) Act 2020, [1.2]-[1.4], [1.8]-[1.9].
267 Corporations Amendment (Corporate Insolvency Reforms) Act 2020Act 2020, cl 453C.
268 Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020 reg 5.3B.03(1).
269 *Idem*, reg 5.3B.03(2).
270 *Idem*, reg 5.3B.03(3).
271 Explanatory Memorandum to the Corporations Amendment (Corporate Insolvency Reforms) Act 2020, [1.25].
272 Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 456C and cl 456B(2).

directors' opinion, the company is insolvent, or is likely to become insolvent at some future time, and that a restructuring practitioner should be appointed.[273]

Restructuring begins when a restructuring practitioner is appointed.[274]

6.5.4.4 Functions of a restructuring practitioner

As the company (and its directors) retain control of the business, property and affairs of the company during the restructuring,[275] the functions of a restructuring practitioner are advisory in nature. They may advise on matters relating to restructuring and assist in preparing a restructuring plan.[276] This is in contrast to the voluntary administration regime where the administrator takes control of a company.[277]

A restructuring practitioner's appointment cannot be revoked[278] and they are not liable for anything done in good faith and without negligence in the exercise of their functions, powers or duties.[279]

To allow the restructuring practitioner to conduct their duties, a director must:

- give the restructuring practitioner information about the company's business, property, affairs and financial circumstances, and allow the restructuring practitioner to inspect and copy the books as reasonably required by the restructuring practitioner;[280] and

- within five days after restructuring begins, declare to the restructuring practitioner, inter alia, any transactions that would be voidable under section 588FE of the Corporation Act.[281]

6.5.4.5 Role of company directors in the restructuring process

Whilst the company is under restructuring, a director commits an offence if they vote in favour or otherwise approve the company purporting to enter a contract or dealing affecting the company's property unless:[282]

- the restructuring practitioner consents;

- it was ordered by the Court; or

[273] *Idem*, cl 453B(1).
[274] *Idem*, cl 453A(a).
[275] *Idem*, cl 453K(1).
[276] *Idem*, cl 453E.
[277] Explanatory Memorandum to the Corporations Amendment (Corporate Insolvency Reforms) Act 2020, [1.54].
[278] Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 456D.
[279] Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020, reg 5.3B.10.
[280] Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 453F(1).
[281] Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020, reg 5.3B.44.
[282] Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 453L.

- the transaction or dealing was in the ordinary course of the company's business.[283]

Any transaction or act done, in good faith, by the restructuring practitioner or by the company with the practitioner's consent, or under Court order, is not liable to be set aside in a winding up of the company.[284]

During restructuring, a company must pay the entitlements of its employees that are payable (other than contingent entitlements) and ensure that its tax lodgments are up to date.[285]

6.5.4.6 Effect of the restructuring process on third party property rights, proceedings, enforcement processes and guarantees

As with the existing voluntary administration regime, rights of third parties in property of the company cannot be exercised during the restructuring, unless the restructuring practitioner consents or the Court grants leave.[286] Similarly, except with consent or leave, Court proceedings, enforcement processes and enforcement of guarantees cannot be begun or proceeded with.[287]

As with the existing voluntary administration regime, a secured party with a security interest over "the whole, or substantially the whole", of the company's property can enforce its security before or during the decision period (being 13 days from when the secured party receives notice of the restructuring process or when the process begins).[288]

6.5.4.7 Stay on enforcing rights – ipso facto clauses

Ipso facto clauses in contracts entered into prior to the restructuring cannot be enforced against the company until the restructuring ends.[289] However, rights that are created under a contract, agreement or arrangement entered into **after** the company comes under restructuring, are not stayed.[290]

The Court has the power to extend or limit a stay, or order that rights only be enforceable with its leave.[291]

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[283] Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020, reg 5.3B.04.
[284] Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 453N.
[285] *Idem*, cl 453N.
[286] *Idem*, cl 453R.
[287] *Idem*, cl 453S, cl 453T, cl 453W.
[288] *Idem*, cl 454C, Corporations Act, s 9 (to be amended by Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 4 in Pt 2, Sch 1).
[289] Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 454N.
[290] *Idem*, cl 454N(5).
[291] *Idem*, cll 454N(3), 454P, 454Q.

6.5.4.8 Restructuring plan

Proposing a restructuring plan

A company may propose a restructuring plan to its creditors (at which point a company is taken to be insolvent).[292] A restructuring plan must be accompanied by a restructuring proposal statement.[293] The restructuring plan must specify how property is to be dealt with and include various terms such as that:[294]

- all admissible debts and claims rank equally and will be paid proportionately (admissible debts and claims are, generally, a debt or claim that would be admissible to proof against the company under section 553 if the company were wound up, but does not include a contingent debt or claim);[295]

- a creditor is not entitled to receive more than the amount of its admissible debt or claim; and

- the amount of an admissible debt or claim will be ascertained as at the time immediately before the restructuring began.

The restructuring plan must not provide for the transfer of property (other than money) to a creditor, or for the company to make payments under the plan (relating to admissible debt or claim), after five years beginning on the day the plan is made.[296]

The restructuring practitioner can cancel the proposal to make a restructuring plan before it is made if they become aware, for example, that affected creditors are not disclosed in the proposal statement or the proposal statement is deficient.[297]

After the restructuring plan is executed (but not yet approved by the affected creditors)

After the company executes a restructuring plan, the restructuring practitioner must:

- prepare a certificate stating, inter alia, that if the restructuring plan is made, the company is likely to be able to discharge the obligations created by the plan as and when they become due and payable;[298] and

- give to affected creditors a copy of the restructuring plan, its terms, the proposal statement and the certificate, and ask each creditor (usually within 15 business days) to state whether

[292] *Idem*, cl 455A.
[293] Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020, reg 5.3B.14.
[294] *Idem*, reg 5.3B.25.
[295] *Idem*, reg 5.3B.01.
[296] *Idem*, reg 5.3B.13(4).
[297] *Idem*, reg 5.3B.18(2).
[298] *Idem*, reg 5.3B.16.

the restructuring plan should be accepted, and whether the creditor agrees with the company's assessment of the amount of the creditor's admissible debts or claims.[299]

A creditor may dispute its admissible debts or claims. The restructuring practitioner must advise the company on the disagreement and give their recommendations for resolving the disagreement.[300]

Acceptance and effect of restructuring plan

A restructuring plan is accepted if a majority in value of the company's affected creditors state that it should be accepted.[301]

Once accepted the restructuring plan is binding on the company, its officers and members, the restructuring practitioner for the plan, creditors to the extent of having an admissible debt or claim and secured creditors to the extent that the value of their security interest is less than their admissible debts or claims.[302]

The restructuring practitioner becomes the "restructuring practitioner for the restructuring plan" (unless another person is appointed), whose functions include paying money to creditors under the plan and administering the plan.[303] However, they must not dispose of property that is subject to a security interest, unless it is in the ordinary course of the company's business, or with consent of the secured party, owner or lessor, or with leave.[304]

Until the restructuring plan terminates, a person bound by the plan cannot apply, or proceed with an application, for an order to wind up the company on the basis of an admissible debt or claim. Nor can such a person begin or proceed with enforcement process to recover an admissible debt or claim, except with leave.[305]

Termination of a restructuring plan

A restructuring plan terminates where:[306]

- all relevant obligations under the plan have been fulfilled and all admissible debts or claims have been dealt with in accordance with the plan;
- the Court makes an order terminating the plan;
- a liquidator, provisional liquidator or administrator is appointed; or

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[299] *Idem*, reg 5.3B.19.
[300] *Idem*, reg 5.3B.20.
[301] *Idem*, 2020 reg 5.3B.23.
[302] *Idem*, 2020 reg 5.3B.27.
[303] *Idem*, reg 5.3B.33.
[304] *Idem*, reg 5.3B.34.
[305] *Idem*, reg 5.3B.28.
[306] *Idem*, reg 5.3B.30.

- if there has been a contravention of the restructuring plan by a person bound by the plan, which has not been rectified within 30 business days.

6.5.4.9 Powers of the Court

The Court has the general power to deal with creditor disputes regarding a proposal for a restructuring plan, and to vary, void, validate or terminate a restructuring plan.[307]

The Court also has the general power to make orders, as it thinks fits, about how Pt 5.3B operates in relation to a particular company.[308] This is consistent with the Court's powers under the voluntary administration regime.

6.5.4.10 End of restructuring

The restructuring ends in circumstances, such as:[309]

- if the company fails to propose a restructuring plan within 20 business days from when the restructuring begins (or by an extended date);[310]
- where the company makes a restructuring plan; or
- where a restructuring practitioner terminates the restructuring if they believe on reasonable grounds, inter alia, that it would not be in the interests of the creditors to make a restructuring plan, or it would be in their interests for either the restructuring to end or the company be wound up;
- where the directors make such a declaration for any reason;
- where the Court orders the restructuring to end; or
- where an administrator, liquidator or provisional liquidator is appointed.[311]

6.5.5 Informal restructuring

To date, the incidence of informal restructuring attempts in Australia has been relatively low. That is primarily due to the traditional anti-collectivist creditor enforcement culture in Australia, whereby creditors have sought to enforce their individual securities and other contractual rights when a company has encountered financial distress, rather than agreeing to postpone their enforcement rights and negotiate new credit terms to allow the company to trade out of its financial difficulties.

[307] *Idem*, regs 5.3B.50-5.3B.54.
[308] Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 458A.
[309] Corporations Amendment (Corporate Insolvency Reforms) Regulations 2020, regs 5.3B.02.
[310] *Idem*, regs 5.3B.01, 5.3B.02(1)(b).
[311] Corporations Amendment (Corporate Insolvency Reforms) Act 2020, cl 453J(1).

As noted in paragraph 6.3.15 above, directors are now able to take advantage of a safe harbour from insolvent trading liability, which protects them from personal responsibility for a company's debts in circumstances where they develop and implement a dedicated informal restructuring plan acting on the advice of an appointed specialist restructuring expert.

The safe harbour is designed to encourage informal rescue attempts for viable companies which, despite current financial difficulties, have a reasonable prospect of being able to return to profitable trade in the longer-term. By providing directors with immunity from insolvent trading liability where the conditions in section 588GA of the Corporations Act are met, the safe harbour acts as a key incentive for directors to pursue an informal rescue attempt for a viable company rather than immediately appointing a voluntary administrator in an effort to invoke the defence to insolvent trading in section 588H(6).

While voluntary administration is one of the prescribed formal mechanisms in Australia designed to achieve corporate or business rescue where possible, in practice those outcomes have been undermined because creditors have used the appointment of an administrator as the trigger to enforce their securities and *ipso facto* contractual rights, destroying the company's enterprise value and leaving little scope to revive the company or achieve a going concern sale of its business.

While the *ipso facto* moratorium discussed in paragraph 6.5.2.5 above is designed to enhance the likelihood of formal corporate rescue attempts via voluntary administration or a creditors' scheme of arrangement, the safe harbour is intended to promote informal rescue without the need to resort to the formal procedures.

It remains to be seen whether the safe harbour reforms will increase the incidence of informal restructuring attempts in Australia. Certainly, there is now added impetus for directors of a financially distressed company to pursue informal restructuring but unless directors can engage with major bank creditors and other key financiers and suppliers at any early stage and gain their support, an informal restructuring attempt will have no prospect of success (with the *ipso facto* moratorium not extending to informal restructuring attempts). Directors will then have no option but to appoint a voluntary administrator or initiate a creditors' voluntary liquidation.

It is expected to take some time before Australia will see any real "cultural shift" away from the existing anti-collectivist creditor culture and stigma associated with insolvency. A key component of any cultural shift will be the quality of the expert restructuring advice received by a financially distressed company and the consequent restructuring plan developed in consultation with an appointed restructuring expert before its presentation to major creditors and suppliers. If directors diligently engage in the process of developing and implementing an informal restructuring at an early stage and ensure that a thorough and co-ordinated restructuring plan is in place, creditors may be persuaded to support the restructuring at least for a limited period of time to give the company a chance to improve its financial condition and return to sustainable trade.

Self-Assessment Exercise 5

Question 1

How have the new reforms introducing a safe harbour for directors from insolvent trading liability and a moratorium on the enforcement of ipso facto contractual rights changed the corporate rescue landscape in Australia?

Question 2

On what grounds, can a company enter voluntary administration? Is insolvency required?

Question 3

What is the court's involvement in a creditors' scheme of arrangement?

For commentary and feedback on self-assessment exercise 5, please see APPENDIX A

7. CROSS-BORDER INSOLVENCY LAW

7.1 General approach

Like other common law countries, Australia has a history of judicial decision-making in cross-border insolvency matters that is based on principles of comity. The decisions of Australian courts broadly reflected the approach of "modified universalism".

7.2 Model Law

In 2008, Australia adopted the UNCITRAL Model Law on Cross-Border Insolvency as the Schedule to the Cross-Border Insolvency Act 2008 (Cth) (CBIA). The CBIA has only 23 sections, giving the Model Law the force of law in Australia and providing the necessary references that each country must insert into their version of the Model Law, being in Australia's case references to the relevant provisions in the Corporations Act and the Bankruptcy Act.

By adopting the Model Law as a stand-alone piece of legislation, Australia avoided the need to adjust the Model Law provisions for integration into both the Corporations Act and the Bankruptcy Act. The resulting single piece of legislation should, it is hoped, encourage consistency in interpretation and application across jurisdictions.

The Explanatory Memorandum to the Bill which introduced the CBIA noted that[312]

> "Australia has a particular interest in uniform interpretation of the Model Law. As a relatively small State it is likely to gain significantly from international jurisprudence on uniform provisions of the Model Law … Harmonised interpretation of the Model Law will be facilitated by the Case Law on UNCITRAL Texts (CLOUT) information system, under which the UNCITRAL secretariat publishes abstracts of judicial decisions (and, where applicable, arbitral awards) that interpret conventions and Model Laws emanating from UNCITRAL. It is expected that Australian courts will make use of international precedents in interpreting the provisions of the Model Law."

7.2.1 Australian choices in its implementation of the Model Law

Australia has made the following choices in its adoption of the Model Law:

- Like many other countries, Australia has chosen to exclude banks and insurance companies from the reach of the Model Law and the CBIA.[313]
- Parts of the Corporations Act have been excluded from the definition of "laws relating to insolvency" for the purposes of Article 1 of the Model Law:[314]
  - the part dealing with receivers, and other controllers, of property of corporations;[315] and
  - the part dealing with windings up of companies by the court on grounds other than insolvency.[316]

Consequently, the Model Law does not provide a mechanism for Australian receivers or controllers of property, or for liquidators of solvent companies, to seek assistance overseas, or for foreign creditors to be involved via the Model Law in Australian receiverships, controllerships or windings up on grounds other than insolvency.

However, it should be recalled that there is no element of reciprocity in the Model Law. Simply because Australia does not treat its receiverships and solvent liquidations as falling within the Model Law, this does not determine the treatment of these proceedings under the Model Law as implemented in other countries. In *Re Betcorp*,[317] a US court held that a members' voluntary (that is, solvent) liquidation could be recognised as a foreign insolvency for the purpose of Chapter 15 of the US Bankruptcy Code, which incorporates the Model Law.

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[312] Cross-Border Insolvency Bill 2008, Explanatory Memorandum, p 19.
[313] Cross-Border Insolvency Regulations 2008 (Cth), r 4, made pursuant to CBIA, s 9 and Model Law, Article 1(2).
[314] CBIA, s 8.
[315] Corporations Act, Part 5.2.
[316] *Idem*, Part 5.4A.
[317] 40 BR 266 (2009).

Also, for the purposes of recognition of a foreign proceeding in Australia, Australian courts have held that, under Article 2 of the Model Law, a "law relating to insolvency" includes a law which provides for the winding up of corporations on grounds which include insolvency, even though the particular winding up for which recognition is sought had been ordered on a ground other than insolvency.[318]

- The courts competent to perform functions under the Model Law are:[319]
  - for individual debtors, the Federal Court of Australia only;
  - for corporate debtors, the Federal Court or any Supreme Court. Thus far, the majority of such applications have been brought in the Federal Court.[320]
- External administrators named under the Model Law are:[321]
  - trustees (in relation to any provision of the Bankruptcy Act, including trustees of personal insolvency agreements and administrators of debt agreements);
  - registered liquidators (in relation to any provision of the Corporations Act, including provisional liquidators, voluntary administrators, deed administrators and scheme administrators).
- In Article 13 of the Model Law dealing with access of foreign creditors to an Australian proceeding, Australia has adopted the alternative version of article 13(2), in such a way that the existing exclusion of foreign tax and social security claims from Australian insolvency proceedings is preserved.[322]
- Australia has supplemented the requirements in Articles 15 and 18 of the Model Law so that the foreign representative must notify the Australian court not only of foreign proceedings affecting the debtor but also of any relevant Australian proceedings affecting the debtor, being:[323]
  - all proceedings under the Bankruptcy Act;
  - any appointment of a receiver;
  - all proceedings under the relevant parts of the Corporations Act (meaning liquidations, provisional liquidations, voluntary administrations, deeds of company arrangement or schemes of arrangement).

[318] *Re Chow Cho Poon (Private) Ltd* [2011] NSWSC 300; (2011) 80 NSWLR 507.
[319] CBIA, s 10.
[320] Atkins, "Australia" in *Cross-border insolvency: a commentary on the UNCITRAL Model Law*, volume 1 (4th ed, 2017), 27.
[321] CBIA, s 11.
[322] *Idem*, s 12; also stated in *Ackers v Deputy Commissioner of Taxation* (2014) 223 FCR 8; [2014] FCAFC 57 at [109].
[323] *Idem*, ss 13 and 14.

- Where in Article 19 the Model Law sets out the relief that may be granted on an urgent basis after an application for recognition has been filed, Australia has not listed any further types of relief in Article 19(2).[324]

- Australia has specified the scope of the stay under Article 20 of the Model Law as being[325] the same as would apply if the stay or suspension arose under:

  (a) the Bankruptcy Act; or

  (b) Chapter 5 (other than Parts 5.2 and 5.4A) of the Corporations Act,

  as the case requires.

Accordingly, when an Australian court is considering a recognition application in relation to a corporate debtor, it needs to consider what "the case requires", that is, whether the case requires the broader voluntary administration stay which affects secured creditors or the standard liquidation stay that affects only unsecured creditors. It is not a question of discretion but rather which stay should apply according to the nature of the proceeding.[326] Where the foreign proceeding is clearly a business rescue procedure, the former will be more appropriate. The latter will be more appropriate for foreign proceedings that are more analogous to liquidations. However, difficult questions will be raised where the foreign proceeding is not clearly either business rescue or liquidation-like.

- The actions to avoid acts detrimental to creditors that are available to a foreign representative under Article 23 are all of the Bankruptcy Act and Corporations Act voidable transaction provisions discussed in paragraphs 6.2.3.11 and 6.3.14 above, "with appropriate changes" that are not further specified.[327]

- Australia has not added any additional forms of cooperation to (f) of Article 27.[328]

- The CBIA provides that the Model Law prevails over the Bankruptcy Act and the relevant Corporations Act sections, to the extent of any inconsistency.[329]

- There is no requirement for reciprocity under the Australian implementation of the Model Law.

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324 *Idem*, s 15.
325 *Idem*, s 16.
326 *Tai-Soo Suk v Hanjin Shipping Co Ltd* [2016] FCA 1404 at [24].
327 CBIA, s 17.
328 *Idem*, s 18.
329 *Idem*, ss 21 and 22.

7.2.2 *Model Law case law*

Four cases are particularly worth noting here.

7.2.2.1 Ackers v Saad Investments[330]

This is the leading Australian decision on COMI. It followed and expressly adopted the principles in *Re Eurofoods IFSC Ltd*[331] that COMI is to be determined having regard to the objectively ascertainable factors of the debtor.

7.2.2.2 Ackers v Deputy Commissioner of Taxation[332]

The decision of the Full Court of the Federal Court of Australia concerned the application of Article 22 of the Model Law whereby the court must be satisfied that the interests of the creditors are "adequately protected" when granting relief under Article 19. In this case, the Cayman Islands liquidation of a Cayman Islands registered company had been recognised as a foreign main proceeding in Australia. The foreign representatives wished to remit approximately AUD 7 million, being the proceeds of sale of the Australian assets of the company, from Australia to the Cayman Islands for distribution there as part of the Cayman Islands liquidation. The company owed over AUD 83 million in tax and penalties in Australia. A debt payable to a foreign revenue creditor is not admissible to proof in a Cayman Islands liquidation (nor is such a debt admissible to proof in an Australian liquidation).

On the application of the Deputy Commissioner of Taxation (DCT), the Federal Court modified the recognition orders, giving leave to the DCT to take steps to enforce its claim in Australia, expressly for the purpose of recovering an amount up to the *pari passu* amount the ATO would have received if they were entitled to prove for the tax debt as an unsecured creditor in the foreign main proceeding. On appeal, the Full Court upheld the decision, finding that the modification of the recognition orders was an appropriate way to ensure that the interests of the DCT as a creditor were adequately protected.

7.2.2.3 The Rizzo-Bottiglieri-de Carlini Armatori decisions

This pair of decisions is a useful illustration of three points arising in the Australian Model law jurisprudence.[333] The proceedings concerned an application to the Federal Court of Australia for recognition of an Italian *fallimento* proceeding. The subject company was an Italian shipping company that owned a fleet of 13 ships. One of those ships was due to collect a shipment of coal at an Australian port. The Italian liquidators were concerned that the ship might be arrested by one of the company's Australian creditors if a moratorium were not in place in Australia.

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[330] *Ackers v Saad Investments Co Limited (in official liq)* (2010) 190 FCR 285; [2010] FCA 1221.

[331] [2006] Ch 508.

[332] (2014) 223 FCR 8; [2014] FCAFC 57.

[333] *Board of Directors of Rizzo-Bottiglieri-De Carlini Armatori SpA v Rizzo-Bottiglieri-De Carlini Armatori SpA* [2018] FCA 153; *Alari v Rizzo-Bottiglieri-de Carlini Armatori SpA* [2018] FCA 1067.

The first notable feature is the Judge's (Justice Rares) identification of a "serious *lacuna*" in the way in which Article 18(a) of the Model Law operates, which did not appear to have been anticipated by the drafters of the Model Law. Once a foreign proceeding comes to an end, the foreign representative no longer represents or controls the company and they no longer have resort to the funds of the company. In those circumstances, the foreign representative is unlikely to feel obliged to perform their obligation under Article 18(a) to inform the recognising court of the end of the foreign proceeding. Also, the recognising court may have no realistic chance of calling the former foreign representative to account for this failure.[334]

This *lacuna* has caused stays in multiple Australian cases to remain in effect in Australia long after the foreign proceeding on which the stay was based has been terminated. His Honour suggested in future that the court either:

- make foreign representatives bringing recognition applications pay into court an amount by way of security, only recoverable on an application under Article 18; or

- only make stay orders under Articles 19, 20 or 21 for a fixed period of say 3 months and to require the foreign representative at regular intervals to report to the Court to justify each extension of the stay, failing which it would be vacated automatically.

In this case, the foreign representatives indicated that they needed only 81 days to complete an auction of the fleet of ships, so his Honour ordered that the recognition and the stay would automatically terminate 81 days after the making of the orders, unless the foreign representatives applied to extend the period.[335]

The second notable feature is the court's determination of which type of Australian stay should apply under Article 20(2) of the Model Law. Justice Rares recognised the Italian *fallimento* proceeding as a foreign main proceeding. His Honour heard and rejected an argument that, because the moratorium in the Italian *fallimento* proceeding also affected secured creditors, the Australian moratorium that should be applied would be the voluntary administration moratorium because it also affects secured creditors. Instead, his Honour found that because the *fallimento* proceeding was analogous to a liquidation, only the liquidation moratorium should apply.[336] See also the discussion of Article 20 in paragraph 7.2.1 above.

The third notable feature concerns the interaction of cross-border insolvency law and maritime law. Justice Rares has said previously that the consequence of allowing the stay and suspension under Article 20(2) to apply to the right of a crew to arrest a ship for unpaid wages would be that the crew could be made *de facto* slaves of the defaulting shipowner until the conclusion of the foreign insolvency.[337] Justice Rares has therefore developed a practice in cross-border insolvency cases involving ships of making an order that any application by a creditor to arrest

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[334] *Board of Directors of Rizzo-Bottiglieri-De Carlini Armatori SpA v Rizzo-Bottiglieri-De Carlini Armatori SpA* [2018] FCA 153 at [27]-[29].

[335] *Board of Directors of Rizzo-Bottiglieri-De Carlini Armatori SpA v Rizzo-Bottiglieri-De Carlini Armatori SpA* [2018] FCA 153 at [51]-[53]; *Alari v Rizzo-Bottiglieri-de Carlini Armatori SpA* [2018] FCA 1067 at [13]-[14].

[336] *Alari v Rizzo-Bottiglieri-de Carlini Armatori SpA* [2018] FCA 1067 at [16]-[17].

[337] *Hur v Samoun Logix Corporation* (2015) 238 FCR 483 at 489 [31]-[33].

a vessel which is the subject of the stay under the Model Law, should be brought before a judge of the Federal Court along with a copy of the order for recognition and copies of the two main authorities in which this issue was discussed.[338]

7.2.2.4 Kelly (Liquidator), in the matter of Halifax Investment Servies (in liquidation) v Loo[339]

In this case, for the first time in Australia, a joint hearing between the Federal Court of Australia and the High Court of New Zealand was held. In 2019, Halifax Australia and Halifax NZ were placed into liquidation. As client funds held on trust by each entity had been commingled, Gleeson J held that this was a "classic candidate" for cross-border cooperation between courts to facilitate a fair and efficient winding up of the companies.[340] A joint hearing was held before Markovic J in the Federal Court of Australia and Venning J in the High Court of New Zealand. Each court delivered separate judgments after deliberating together about the principal issues.

7.3 The Bankruptcy Act and Corporations Act assistance provisions

In relation to bankruptcy and insolvency matters, the Corporations Act[341] and the Bankruptcy Act[342] each contain provisions which:

(a) require all Australian courts to "act in aid of, and be auxiliary to", the courts of certain other listed countries (some Commonwealth countries, the United States and Switzerland);

(b) permit the Australian courts to act in aid of and be auxiliary to, the courts of any other country; and

(c) empower the Australian courts to request the assistance of other courts.

These provisions have their history in English legislation whereby British colonies and former British colonies were empowered to assist one another and request assistance. Such assistance is usually sought by way of a "letter of request" issued by one court to another.[343] The equivalent English provision is section 426 of the Insolvency Act 1986 (UK), which was considered in *Rubin v Eurofinance SA* (*Rubin*),[344] where Australian liquidators had applied for UK recognition of an Australian judgment in proceedings brought by the liquidators to recover preferential payments. The UK Supreme Court found that the section does not apply to the recognition of foreign judgments.

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338 Being *Yu v STX Pan Ocean Co Ltd* (2013) 223 FCR 189 and *Yakushiji v Daiichi Chuo Kaisen Kaisha* [2015] FCA 1170.
339 [2021] FCA 531.
340 *Re Kelly (as joint and several liquidators of Halifax Investment Services Pty Ltd (in liq)) and Others (No 5)* (2019) 139 ACSR 56 at [76].
341 At s 581.
342 At s 29.
343 For a discussion of the history of this regime, see Paul J Omar (2002), "Co-Operation between Courts: The Common Law Legacy" in *The Paul J Omar* Collection, The International Insolvency Institute, Academic Forum Collection, available at https://www.iiiglobal.org/sites/default/files/cooperationbetweencourtsthecommonlawlegacy.pdf, accessed 20 December 2018.
344 [2012] UKSC 46; [2013] 1 AC 236 at [145]-[154] per Lord Collins of Mapesbury.

The CBIA[345] provides that the Model Law prevails over these Bankruptcy Act and Corporations Act sections, to the extent of any inconsistency. In most cases, these provisions will be overtaken by Article 25 of the Model Law, which requires Australian courts to co-operate to the maximum extent possible with all foreign courts, in relation to matters within the scope of the Model Law.

7.4 Court rules, protocols and memoranda regarding co-operation

The uniform Corporations Rules for the Supreme Courts and the Federal Court set out rules for proceedings under the CBIA.[346] Each of these courts, except the Queensland Supreme Court, has provided in its rules or in a practice note that co-operation under the Model Law which involves the court and a foreign court or foreign representative, should generally occur in accordance with a protocol or co-ordination agreement prepared by the parties and approved by the Court. The practice notes state that in preparing a protocol the parties should have regard to:

- the *Guidelines Applicable to Court-to-Court Communication in Cross-Border Cases* published by The American Law Institute and The International Insolvency Association available at http://iiiglobal.org; and

- the *UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation* available at http://www.uncitral.org.

The Supreme Court of New South Wales has also expressly adopted the *Judicial Insolvency Network Guidelines for Communication and Cooperation between Courts in Cross-Border Insolvency Matters* (JIN Guidelines) and has attached them to its cross-border insolvency cooperation practice note.[347]

One development outside of the Model Law is also worth noting here. In 2010, the then Chief Justice of the Supreme Court of New South Wales signed a Memorandum of Understanding on References of Questions of Law with the Chief Justice of the Supreme Court of Singapore and another with the Chief Judge of New York State.[348] The memoranda set out a system for referral for non-binding answers on questions of foreign law, including insolvency law, between the judges of the two jurisdictions, if the parties to the relevant proceeding consent. There is, as yet, no Australian case law applying the memoranda.

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345 At s 22.

346 Division 15A of the Supreme Court (Corporations) Rules of each State and Territory and the Federal Court (Corporations) Rules.

347 Supreme Court of New South Wales Practice Note SC EQ 6 - Cross Border Insolvency: Cooperation with Foreign Courts or Foreign Representatives, available at http://www.practicenotes.justice.nsw.gov.au/practice_notes/nswsc_pc.nsf/a15f50afb1aa22a9c%20a2570ed000a2b08/4f96eb1106eb1b61ca25819f0002a5dc, accessed 15 December 2018.

348 Both available at http://www.supremecourt.justice.nsw.gov.au/Pages/sco2_practiceprocedure/sco2_internationaljudicialcooperation/sco2_internationaljudicialcooperation.aspx, accessed 30 December 2018.

Self-Assessment Exercise 6

Question 1

Does the Australian implementation of the Model Law apply to Australian banks and insurance companies?

Question 2

Briefly describe the three Australian Model Law issues which arise in the *Rizzo-Bottiglieri-de Carlini Armatori* decisions.

For commentary and feedback on self-assessment exercise 6, please see APPENDIX A

8. RECOGNITION OF FOREIGN JUDGMENTS

There are five different avenues to consider when determining whether a foreign insolvency judgment will be recognised by an Australian court:

- the common law;
- the Foreign Judgments Act 1991 (Cth);
- section 581 of the Corporations Act;
- Articles 21 and 22, or 25, of the Model Law, as set out in the CBIA;
- the Trans-Tasman Proceedings Act 2010 (Cth), which provides for streamlined recognition of New Zealand judgments only.

The first four of these avenues are almost identical to four of the six English avenues for recognition of foreign insolvency judgments considered by the UK Supreme Court in the important decision of *Rubin*.[349]

To understand the Australian position regarding recognition of foreign insolvency judgments, all students should read the clear and concise speech of Nye Perram, a Justice of the Federal Court of Australia, given to the Judicial Insolvency Network Conference in Singapore in October 2016.[350]

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[349] [2012] UKSC 46; [2013] 1 AC 236.

[350] Nye Perram "Issues in recognition and enforcement of foreign insolvency judgments - An Australian perspective", speech presented at the Judicial Insolvency Network Conference, Singapore, 10 October 2016, [2016] FedJSchol 13 available at http://classic.austlii.edu.au/au/journals/FedJSchol/2016/13.html, accessed 31 December 2018.

8.1 Foreign Judgments Act

The Foreign Judgments Act allows for the registration of money judgments from the superior courts, and some inferior courts, of 34 nominated jurisdictions.[351] The list of jurisdictions includes the UK, France, Germany, Hong Kong, Singapore and some Canadian states, but it does not include, for example, the USA, China or India. Other countries can be added to the list if the Australian Governor-General is satisfied that the country will afford substantial reciprocity of treatment in its courts for Australian judgments.[352]

On an application being made, the court is obliged to register the judgment unless it has already been fully satisfied or is not enforceable in the country in which it was given.[353] Once a foreign judgment is registered, the judgment has the same force and effect as a local judgment and may be enforced in the same way.[354]

Once a judgment has been registered, the judgment debtor can apply to have the registration set aside on any of the grounds set out in section 7(2)(a), which include:

(a) that the courts of the country of the original court had no jurisdiction in the circumstances of the case; or

(b) that the judgment debtor, being the defendant in the proceedings in the original court, did not (whether or not process had been duly served on the judgment debtor in accordance with the law of the country of the original court) receive notice of those proceedings in sufficient time to enable the judgment debtor to defend the proceedings and did not appear; or

(c) that the judgment was obtained by fraud; or

(d) that the judgment has been reversed on appeal or otherwise set aside in the courts of the country of the original court; or

(e) that the rights under the judgment are not vested in the person by whom the application for registration was made; or

(f) that the judgment has been discharged; or

(g) that the judgment has been wholly satisfied; or

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[351] Being: Alberta, Bahamas, British Columbia, British Virgin Islands, Cayman Islands, Dominica, Falkland Islands, Fiji, France, Germany, Gibraltar, Grenada, Hong Kong, Israel, Italy, Japan, Korea, Malawi, Manitoba, Papua New Guinea, Poland, St Helena, St Kitts and Nevis, St Vincent and the Grenadines, Seychelles, Singapore, Solomon Islands, Sri Lanka, Switzerland, Taiwan, Tonga, Tuvalu, United Kingdom and Western Samoa. See Foreign Judgments Regulations 1992 (Cth).

[352] Foreign Judgments Act, s 5(1).

[353] *Idem*, ss 6(3), 6(6).

[354] *Idem*, s 6(7).

(h) that the enforcement of the judgment … would be contrary to public policy.

If any of these grounds are made out, the registration must be set aside.[355]

The question of jurisdiction posed in section 7(2)(a)(iv) is answered in section 7(3):

> "(3) For the purposes of subparagraph (2)(a)(iv) … the courts of the country of the original court are taken to have had jurisdiction:
>
> (a) in the case of a judgment given in an action *in personam*:
>
> (i) if the judgment debtor voluntarily submitted to the jurisdiction of the original court; or
>
> (ii) if the judgment debtor was plaintiff in, or counter-claimed in, the proceedings in the original court; or
>
> (iii) if the judgment debtor was a defendant in the original court and had agreed, in respect of the subject matter of the proceedings, before the proceedings commenced, to submit to the jurisdiction of that court or of the courts of the country of that court; or
>
> (iv) if the judgment debtor was a defendant in the original court and, at the time when the proceedings were instituted, resided in, or (being a body corporate) had its principal place of business in, the country of that court; or
>
> (v) if the judgment debtor was a defendant in the original court and the proceedings in that court were in respect of a transaction effected through or at an office or place of business that the judgment debtor had in the country of that court; or
>
> (vi) …"

8.2 Common law

The common law of Australia regarding recognition of foreign judgments is very similar to that of England. An Australian court will recognise a foreign judgment where:[356]

(a) the foreign court has exercised the jurisdiction "in the international sense" (discussed below);

(b) the judgment is final and conclusive;

(c) the parties to the Australian recognition application are the same as those in the foreign judgment; and

(d) if the judgment is *in personam*, it must be:

(i) for a fixed or readily calculable sum of money;

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[355] *Idem*, s 7(2)(a).

[356] See generally the leading Australian text on private international law: Davies, Bell and Brereton, *Nygh's Conflict of Laws in Australia* (9th ed, 2014) at 895-935.

(ii) obtained within the last 12 years; and

(iii) not wholly satisfied.

However, an Australian court will not recognise a foreign judgment if:

- the judgment was obtained by fraud and the allegation of fraud was not and could not have been raised before the foreign court;
- the enforcement of the judgment would be contrary to public policy (which includes not enforcing judgments based on foreign revenue debts or penalties imposed by foreign law); or
- the judgment debtor was denied natural justice in the foreign court (for example, they were not notified of the proceeding).

The question of whether the foreign court has jurisdiction over a person is determined by the law of Australia and not by whether the foreign court has jurisdiction under its domestic law. That is what is meant by jurisdiction "in the international sense". Under the common law of Australia, a foreign court will have exercised jurisdiction in the international sense where:

(a) the defendant was present or resident in, or a subject of, the foreign jurisdiction; or

(b) the defendant voluntarily submitted to the jurisdiction of the foreign court.

An individual will be a subject of the foreign jurisdiction if, for example, they hold a passport of that jurisdiction or are registered to vote there.[357] A corporation is within the jurisdiction of a foreign court if it carries on business in that jurisdiction "at a definite, and to some reasonable extent, permanent place".[358]

A default judgment can be "final and conclusive" for the purposes of recognition, so long as it has not been set aside in the foreign jurisdiction.[359]

Once a foreign judgment is recognised in Australia under common law principles, it has the same force and effect as a local judgment and may be enforced in the same way.

There remains a question in Australia of whether the common law permits recognition of foreign insolvency judgments on the basis of principles which differ from those applying to *in personam* or *in rem* judgments. Before the decision in *Rubin*, it appeared that Australian courts were most likely to apply the principles that had been set out by the UK Privy Council and the House of

[357] *Idem*, at 905.

[358] *Idem*, at 898, citing the English decision of *Littauer Glove Corp v F W Millington (1920) Ltd* (1928) 44 TLR 746 per Salter J and the Australian decision of *Bushfield Aircraft Co v Greater Western Aviation Pty Ltd* (1996) 16 SR (WA) 97. See also *National Commercial Bank v Wimborne* (1979) 11 NSWLR 156 at 165.

[359] *Idem*, at 908-9.

Lords respectively in the *Cambridge Gas*[360] and *Re HIH* decisions.[361] Those decisions recognised insolvency judgments as being neither *in personam* nor *in rem* but rather of their own third type. The common law principles that applied to their recognition were different, being based on the principle of modified universalism and requiring the court to co-operate with the foreign court to ensure that all of the company's assets are distributed to its creditors under a single system of distribution.

In England, *Cambridge Gas* and *Re HIH* have now been overtaken by *Rubin*, in which insolvency judgments (at least where they concern preference claims) were held to be *in personam* judgments. It remains to be seen whether the Australian common law will take the same course.

8.3 The aid provisions in the Corporations Act and the Bankruptcy Act

As discussed in paragraph 7.3 above, under section 581 of the Corporations Act and s 29 of the Bankruptcy Act, Australian courts must act in aid of some countries and are given a discretion to act in aid of others. Australian courts have not been called upon to determine whether these sections confer power to recognise foreign insolvency judgments that are not otherwise recognisable under the common law or the Foreign Judgments Act.

However, it is likely that an Australian court would reach the same conclusion as the UK Supreme Court reached in *Rubin* regarding the equivalent English provision, being that it does not apply to the recognition of foreign judgments.

8.4 Article 21 and Article 25 of Model Law

Australian courts are yet to seriously consider the questions of whether Article 21 or Article 25 of the Model Law give an Australian court a discretion to recognise a foreign insolvency judgment.

There seems to be general agreement that Article 25 is unlikely to support the recognition of foreign judgments. The question regarding Article 21 is more complex.

In a 2011 decision, a senior and eminent Judge of the Supreme Court (Barrett J) stated in *obiter* (being a comment that is not strictly necessary to the decision being made) that:[362]

> "[a] foreign representative seeking an order of the local court for a purpose such as securing assets in the local jurisdiction or *enforcing in the local jurisdiction an order of the foreign court* may utilise Art 21 after a recognition order has been made in respect of the foreign proceeding[.]" (Emphasis added.)

In a speech in 2013, Barrett J indicated that he had not realised at the time that he made this statement that it might be controversial and he was "assuming that such enforcement would,

[360] *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings Plc* [2006] UKPC 26; [2007] 1 AC 508.

[361] *In re HIH Casualty and General Insurance Ltd* [2008] 1 WLR 852.

[362] *Re Chow Cho Poon (Private) Ltd* [2011] NSWSC 300; (2011) 80 NSWLR 507 at [65].

virtually by definition, be viewed as something that was necessary to protect the assets of the debtor or the interests of the creditors."[363]

Students will recall that in 2013 in *Rubin*,[364] the UK Supreme Court found that neither Article 21 nor Article 25 of the UK's implementation of the Model Law allowed the recognition of foreign insolvency judgments relating to overseas preference claims. The Australian implementations of Articles 21 and 25 are in relevantly identical terms. As discussed in paragraph 4.1 above, English decisions are considered highly persuasive in Australian courts but they are not binding.

The equivalent provisions in the US are sections 1521 and 1525 of Chapter 15 of the US Bankruptcy Code. The US also has an additional provision which sets out additional assistance that the US courts can give (section 1507). US courts have interpreted their implementation of the Model Law as permitting US courts to make orders enforcing foreign restructuring plans under sections 1507 and 1521.[365]

In his 2013 speech, Justice Barrett went on to say that it would be unfortunate if the narrow interpretation of Article 21 by the UK Supreme Court in *Rubin* were to prevail.[366] In his speech to the Judicial Insolvency Network Conference, Justice Perram expresses some doubt as to whether Australian courts will follow *Rubin* when it comes to Article 21 of the Model Law.

Australian courts are required to have regard to foreign decisions when interpreting the Model Law.[367] When considering whether the Australian implementation of the Model Law applies to recognition of foreign insolvency judgments, the Australian courts will have to grapple with the difference of opinion between the English courts and the US courts. Whilst English decisions are generally given more weight in Australian courts than US decisions, in the area of cross-border insolvency law, the US position cannot be so easily dismissed.

Self-Assessment Exercise 7

A company incorporated in Australia, which has offices in both Australia and Singapore, traded with a Singaporean company out of the Australian company's Singapore office. A liquidator is subsequently appointed to the Singaporean company. The liquidator brings an unfair preference claim in a superior court in Singapore against the Australian company. The Australian company is given proper notice of the proceeding. The Australian company chooses not to appear before the Singaporean court to defend the proceedings. The Singaporean court enters a default judgment against the Australian company.

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363 R I Barrett (2013), 'Commentary on "Cross-border insolvency – Judicial Assistance in the Post-Hoffman Era", paper presented at the 30th Annual Conference of the Banking and Financial Services Law Association, 30 August 2013, available at http://www.austlii.edu.au/au/journals/NSWJSchol/2013/26.pdf, accessed 30 December 2018, p 5.

364 [2012] UKSC 46; [2013] 1 AC 236.

365 See for example *In re Vitro S.A.B. de CV*, 701 F 3d 1031 2012; *In re Rede Energia SA*, 515 BR 69, Bkrtcy SDNY 2014.

366 *Ibid*.

367 Cross-Border Insolvency Bill 2008, Explanatory Memorandum, p 19.

Will the default judgment be recognised in Australia? If so, which of the four avenues discussed in Sections 8.1 to 8.4 above would you recommend the liquidator pursue in seeking recognition of the judgment in Australia?

For commentary and feedback on self-assessment exercise 7, please see APPENDIX A

9. INSOLVENCY LAW REFORM

9.1 Simplified liquidation process and restructuring process for small companies

The major recent reforms to Australian insolvency law are the introduction in late 2020 of "simplified liquidations" and restructuring plans for small companies with less than AUD 1 million in liabilities. These are discussed at paragraphs 6.3.17 and 6.5.4 above.

9.2 Anti-phoenixing laws

In 2019 and early 2020, new laws were introduced in an attempt to reduce the impact and incidence of "phoenix company activity" in Australia.

Phoenix company activity is an anti-avoidance practice which has occurred for decades in Australia despite previous law reform efforts. In essence, phoenix activity involves "asset-stripping", where directors remove assets from a company and allow debts to accumulate in the name of the company before placing it in liquidation and then (like a phoenix rising from the ashes) recommencing the company's business under a new name.

The amendments introduced in 2019 were aimed at deterring directors from attempting to avoid paying the company's employees in an insolvency context. These amendments:[368]

- expanded the provisions which impose civil and criminal liability on directors and related entities that enter into transactions with the subjective intention of avoiding the payment of outstanding employee entitlements to also capture transactions entered into which are "reasonably likely to prevent or significantly reduce the recovery of employee entitlements";[369]

- gave the court a power to make an "employee entitlements contribution order" against a parent company or another entity which has benefited from the services of employees of a company being liquidated where it is just and equitable for the order to be made,[370] for example where the assets of group entities have been intermingled and a subsidiary company has been intentionally left with insufficient capital to discharge its liabilities. This is

[368] Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019 (Cth).
[369] Corporations Act, ss 596AB(1A) and 596AC.
[370] *Idem*, s 588ZA(1).

a particularly significant reform, permitting contribution orders to be made against solvent parent entities for the first time (as noted in paragraph 6.3.12 above, currently there is only provision for the pooling of multiple insolvent group companies being liquidated at the same time). However, the scope of the new contribution orders is limited and other "vulnerable" unsecured creditors apart from employees, such as tort creditors and small suppliers, remain exposed to phoenix company activity; and

- gave ASIC the power to disqualify a person from being a director for up to five years[371] and a court may elect to disqualify a person from being a director for a period it considers appropriate[372] if, within a seven-year period and in relation to two or more failed companies, the person was an officer of the companies, the person contravened the Corporations Act or failed to prevent the companies from doing so, an amount was advanced under the Fair Entitlements Guarantee Scheme to meet unpaid employee entitlements of the companies and the Government received only a minimal return of 10 cents in the dollar or less on the amount advanced.

The amendments introduced in February 2020 imposed further direct liabilities on directors who phoenix companies.[373]

First, a new voidable transaction provision has been introduced into the Corporations Act to enable a liquidator to recover a "creditor-defeating disposition", defined to mean a disposition of company property which has the effect (irrespective of intention) of preventing, hindering or significantly delaying the property becoming available for creditors in the event of a winding up,[374] where the disposition:

- occurred when the company was insolvent or caused the company to become insolvent; or

- was entered into in the 12-month period before the commencement of external administration, provided the external administration was a direct or indirect result of the disposition.[375]

A director will face personal liability if they fail to prevent the company from entering into a creditor-defeating disposition and the director knows, ought to have known or was reckless as to the result of the disposition.[376] Other persons, such as pre-insolvency advisers and related entities, who procure, incite, induce or encourage a company to make a creditor-defeating transfer of company assets will also face liability in the same circumstances.[377]

The amendments also include other reforms which:

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[371] *Idem*, s 206GAA.
[372] *Idem*, s 206EAB.
[373] Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020 (Cth).
[374] *Idem*, s 588FDB.
[375] *Idem*, s 588FE(6B).
[376] *Idem*, ss 588GAA, 588GAB, 588J(1A), 588K(2), 588M(1A).
[377] *Idem*, s 588GAB.

- prevent directors from backdating their resignations in an attempt to avoid personal liability for insolvent trading and other breaches of the Corporations Act, which depend on a person being a director at the time of the relevant breach;[378]

- prevent directors from resigning where that would leave the company as an empty shell with no directors – previously this has been a hallmark of the behaviour of directors seeking to avoid liability in the context of a phoenix company scheme;[379]

- extend the Commissioner of Taxation's current power to issue a director penalty notice to directors in relation to the company's failure to remit withholding amounts for employee personal income tax and superannuation (with the issue of the penalty notice causing directors to become personally liable if the amounts are not subsequently remitted within 21 days, or the directors do not otherwise cause the company to enter liquidation or voluntary administration);[380]

- allow the Commissioner of Taxation to retain any tax refund owing to a company if the company has failed to lodge an overdue tax return or provide other outstanding information to the Australian Taxation Office;[381] and

- prevent related creditors that have colluded in phoenix activity before a company enters external administration from being able to vote to appoint, and keep in place, a "friendly" liquidator or voluntary administrator who will in effect turn a blind eye to, and fail to investigate, the phoenix activity.[382]

10. USEFUL INFORMATION

10.1 General information about the Australian economy and business regulation

The World Bank's comparative data on various world economics including Australia can be found at:

World Bank, Doing Business 2020 Economy Profile: Australia, available at http://www.doingbusiness.org/content/dam/doingBusiness/country/a/australia/AUS.pdf, accessed on 3 May 2021.

10.2 Bankruptcy

AFSA, What are the consequences of bankruptcy?, available at https://www.afsa.gov.au/insolvency/i-cant-pay-my-debts/what-are-consequences-bankruptcy, accessed on 30 December 2018.

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[378] *Idem*, s 203AA.
[379] *Idem*, ss 203AB, 203CA.
[380] Taxation Administration Act 1953 (Cth), sch 1, ss 268-269.
[381] *Idem,* s 8AAZLG.
[382] *IPRC*, rr 75-95(1A), 75-110(7).

For a simple comparison of bankruptcy, personal insolvency agreements and debt agreements, see AFSA, *Compare the formal options*, at https://www.afsa.gov.au/insolvency/i-cant-pay-my-debts/compare-formal-options, accessed 10 December 2018.

10.3 Corporate insolvency

For a 20-minute overview of Australian corporate insolvency regimes, view from timestamp 4:11 to timestamp 23:36 in the talk given by Emma Beechey and Ishana Tripathi for Jindal Global University, titled *Schemes, Deeds, Prepacks and Group Insolvencies: an Australian Insight*, livestreamed on 23 March 2021, at https://youtu.be/1WkKtr416Zo.

A good comparison of Australian voluntary administrations and US Chapter 11 proceedings produced by Baker McKenzie in 2016 is at https://www.bakermckenzie.com/-/media/files/insight/publications/2016/01/us-chapter-11-bankruptcy/qrg_australia_uschapter11_jan16.pdf?la=en, accessed 2 December 2018.

10.4 Recognition of foreign judgments

Nye Perram "Issues in recognition and enforcement of foreign insolvency judgments - An Australian perspective", speech presented at the Judicial Insolvency Network Conference, Singapore, 10 October 2016, [2016] FedJSchol 13 available at http://classic.austlii.edu.au/au/journals/FedJSchol/2016/13.html, accessed 31 December 2018.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

For each of personal bankruptcy and corporate insolvency, what is:
- the governing legislation;
- the relevant regulatory body; and
- the courts in which proceedings may be brought?

Question 2

In terms of insolvency law, is Australia considered to be a debtor-friendly or a creditor-friendly jurisdiction? Why?

Commentary and Feedback on Self-Assessment Exercise 1

Question 1

Personal bankruptcy is governed by the Bankruptcy Act 1966 (Cth) and regulated by the Australian Financial Securities Authority (AFSA) and bankruptcy matters are heard only in the Federal Court of Australia and the Federal Circuit Court. Corporate insolvency is governed by the Corporations Act 2001 (Cth), it is regulated by the Australian Securities and Investment Commission (ASIC) and corporate insolvency matters can be heard in the Federal Court or the Supreme Courts of any of the states or territories.

Question 2

Australia is considered a creditor-friendly jurisdiction because the primary focus is on the protection of creditors' rights in insolvency situations. For example

- almost all of Australia's bankruptcy and insolvency processes involve the appointment of an external administrator, rather than being debtor-in-possession processes (except schemes of arrangement, and small business restructurings although there a qualified insolvency practitioner must still be appointed as an advisor)
- secured creditors are entitled to enforce their rights during the bankruptcy and liquidation processes
- major creditors with security over the whole or substantially the whole of a company's property are entitled to appoint a receiver over the top of a voluntary administrator
- Australia has broad insolvent trading liability for directors and a voidable transaction regime, both of which allow substantial sums to be clawed back for the benefit of creditors.

Self-Assessment Exercise 2

A foreign company takes security governed by Australian law over the fleet of trucks of an Australian trucking company. The foreign company waits 30 days before registering its security interest on the PPSR. Five months after the security interest was granted, the company is placed into voluntary administration. What happens to the security interest over the trucks?

Commentary and Feedback on Self-Assessment Exercise 2

The security interest in the fleet of trucks vested in the debtor company immediately before the debtor company entered voluntary administration. This is because the security interest was granted less than six months before the external administration began and it was not registered within 20 days of its having been created.

Self-Assessment Exercise 3

What options are available for an individual to deal with their indebtedness outside the formal bankruptcy process in Australia? What are the incentives for a person to do so?

Commentary and Feedback on Self-Assessment Exercise 3

- Mention should be made of the two formal non-bankruptcy alternatives available for a distressed individual debtor in Australia: personal insolvency agreements and debt agreements.
- For both of those alternatives, it is a precondition that the debtor is insolvent, meaning that they are unable to pay their debts as and when the debts become due and payable.
- Additionally, even if a person is not insolvent, they may seek to enter into an informal arrangement with creditors outside bankruptcy. Of course, in the absence of any statutory moratorium or restrictions on the enforcement of creditors' *ipso facto* contractual rights, an informal arrangement will not succeed unless major financiers can be persuaded to refrain from exercising their enforcement rights. In practice, this will require the debtor to at least secure the injection of funds from a third party for distribution to creditors.

- In contrast, personal insolvency agreements and debt agreements can be negotiated and implemented with the benefit of a statutory moratorium. Nevertheless, there is a high approval threshold from creditors for personal insolvency agreements (at least 50% in number and 75% in value of all creditors voting at the meeting of creditors). There is a less stringent approval requirement, being the majority of creditors who respond to the Official Receiver's call to vote, in the context of a debt agreement, although debt agreements can only be resorted to by debtors with smaller estates, lower outstanding unsecured debts and lower personal income levels.

- The benefit for a debtor of a formal or informal non-bankruptcy alternative is that many of the adverse consequences of formal bankruptcy proceedings, including travel restrictions, the requirement to disclose the debtor's bankruptcy status to new lenders where the amount borrowed exceeds a prescribed level and (except for personal insolvency agreements) the inability to manage companies, will not apply if bankruptcy can be avoided.

Self-Assessment Exercise 4

Question 1

To what extent is a company's insolvency a pre-requisite for corporate liquidation in Australia?

Question 2

What avenues are available for a liquidator to recover property from third parties to expand the pool available for distribution to creditors? What are the practical limitations, if any, of those avenues?

Commentary and Feedback on Self-Assessment Exercise 4

Question 1

- It is possible for a company to be liquidated in Australia by way of a members' voluntary liquidation, in which case the company is in fact required to be solvent as a precondition for the liquidation to proceed.
- Otherwise, a company can only be liquidated in Australia by way of a creditors' voluntary winding up or a compulsory winding up.
- In the former case, insolvency is a prerequisite for the liquidation to proceed pursuant to section 497 of the Corporations Act.
- In the latter case, insolvency is also a prerequisite under section 459A of the Corporations Act but it should be noted that, in practice, proof of insolvency is rarely required on the application by a creditor (or other interested party) to wind up a company. That is because a creditor will typically be able to rely on statutory presumptions of insolvency set out in section 459C of the Corporations Act. Of particular note, a company will be presumed to be insolvent if it has not complied with a statutory demand in the three-month period before an application is filed to wind up the company. While the presumption is rebuttable, the onus is on the company to do so and in practice the insolvency position of the company is clear.

Question 2

- First, a liquidator (or ASIC) may pursue a director for insolvent trading under section 588G of the Corporations Act, or a holding company under the equivalent provision in section 588V of the Corporations Act. In practice, Australia's insolvent trading laws have until recently been regarded as being among the harshest in the world, with limited defences available and directors previously unable to avoid personal liability if they caused a company to incur a debt in pursuit of a genuine restructuring attempt.
- However, the safe harbour from insolvent trading provides a new means for directors to avoid personal liability for insolvent trading in circumstances where they pursue a restructuring attempt under the advice of a specialist restructuring expert and the company has a realistic prospect of being able to trade out of its current financial difficulties. That said, the safe harbour should not be seen as any kind of guaranteed immunity for directors, who must remain actively involved in the development of a restructuring plan and diligently monitor the company's financial performance to be able to invoke the carve-out to personal liability.
- Second, a liquidator may resort to the voidable transaction provisions of the Corporations Act to recover dispositions of property by a company which are unfair preferences, uncommercial transactions, unreasonable director-related transactions or unfair loans. The unfair preference and uncommercial transactions provisions are only able to recover property if a transaction was entered into at the time the company was insolvent or otherwise caused the company to become insolvent. The unreasonable director-related transactions and unfair loans provisions do not have the same insolvency limitation, but they apply to only a limited range of transactions.
- Note that if a company is undergoing a simplified liquidation, the only voidable transactions that can be recovered are unfair preferences of over $30,000 that were paid to related parties of the company in the three months prior to the commencement of the liquidation.

Self-Assessment Exercise 5

Question 1

How have the new reforms introducing a safe harbour for directors from insolvent trading liability and a moratorium on the enforcement of ipso facto contractual rights changed the corporate rescue landscape in Australia?

Question 2

On what grounds, can a company enter voluntary administration? Is insolvency required?

Question 3

What is the court's involvement in a creditors' scheme of arrangement?

Commentary and Feedback on Self-Assessment Exercise 5

Question 1

Your answer should address the fact that, before the introduction of the safe harbour in section 588GA of the Corporations Act, directors of a company would typically appoint a voluntary administrator at the first sign of financial trouble in an attempt to avoid personal liability for insolvent trading (by invoking the defence to liability under section 588H(6) of the Corporations Act). While voluntary administration is a *formal* corporate rescue mechanism in Australia, in practice the previous experience was that the appointment of a voluntary administrator would invariably cause creditors to invoke their *ipso facto* contractual rights and / or enforce their securities where the voluntary administration moratorium did not apply. That outcome compromised the success of a formal corporate or business rescue attempt under a DOCA.

The new *ipso facto* moratorium is likely to enhance the prospect of a company being resuscitated, or at least its business being preserved by way of a going concern sale, insofar as it will preserve a company's enterprise value while a voluntary administrator investigates the company's affairs, including whether a DOCA is feasible, before reporting to creditors. Notably, however, the moratorium does not prevent a creditor with a security interest over the whole or substantially the whole of a company's property from appointing a receiver over the top of a voluntary administrator, meaning that the practical achievement of corporate or business rescue is still heavily dependent on the support of a company's major financiers.

The safe harbour from insolvent trading liability is likely to encourage directors to pursue an informal restructuring attempt acting on the advice of a restructuring expert where the company, despite existing financial difficulties, is likely to be able to trade out of those difficulties in the longer-term. Again, however, the success of an informal restructuring attempt will depend on the support of key financiers and suppliers, noting the *ipso facto* moratorium does not apply during such an attempt.

Accordingly, while the safe harbour and *ipso facto* moratorium reforms are important steps in promoting corporate and business rescue in Australia, in both formal and informal restructuring attempts, a successful restructuring ultimately depends on a change in the underlying anti-collectivist creditor enforcement culture which exists in Australia. That process is expected to take quite some time.

Question 2

A company can enter voluntary administration after a majority of the company's directors resolve that, in their opinion, the company is insolvent or is likely to become insolvent at some future time and that an administrator should be appointed. Actual insolvency is not required, the likelihood of insolvency at some future point in time is sufficient.

Alternatively, a liquidator or provisional liquidator of a company can place a company into voluntary administration if they think that the company is, or is likely to become, insolvent. Actual insolvency is not required, the likelihood of insolvency at some future point in time is sufficient.

Thirdly, a creditor with a security interest over the whole, or substantially the whole, of the company's property can appoint a voluntary administrator (rather than a receiver) when the security interest has become enforceable. This ground does not require insolvency or likely insolvency.

Question 3

Two court applications are required.

The first application is for an order convening the meeting of creditors. On that application, the court will consider the terms of the proposed scheme and the proposed classes of creditors for voting.

On the second application, the court will be asked to formally approve the scheme. The court will generally do so if there has been full disclosure of all material matters concerning the scheme to creditors, the meeting or meetings of creditors have been properly convened and there is no clear circumstance of unfairness or injustice (on the basis that the court considers creditors to be better judges of their own commercial interests than the court).

Self-Assessment Exercise 6

Question 1

Does the Australian implementation of the Model Law apply to Australian banks and insurance companies?

Question 2

Briefly describe the three Australian Model Law issues which arise in the *Rizzo-Bottiglieri-de Carlini Armatori* decisions.

Commentary and Feedback on Self-Assessment Exercise 6

Question 1

No.

Question 2

- The 'serious lacuna' in relation to Article 18(a) of the Model Law, whereby the former foreign representative has no incentive to inform a recognising court of the termination of a foreign proceeding, with the result that Australian stays will remain in force long after the relevant foreign proceeding has been terminated.
- The process for determining which of the Australian stays should apply to a recognised foreign main proceeding: the voluntary administration stay which affects secured creditors or the liquidation stay which does not affect secured creditors. The correct stay to apply is determined by the nature of the proceeding and whether it is more analogous to an Australian voluntary administration or a liquidation.
- The interaction between the Model Law and the right of a maritime lien holder to seek the arrest of a ship. The Federal Court has developed a practice whereby maritime lien holders can apply to the Federal Court for the arrest of a ship and must bring the relevant case law to the Court's attention on that application.

Self-Assessment Exercise 7

A company incorporated in Australia, which has offices in both Australia and Singapore, traded with a Singaporean company out of the Australian company's Singapore office. A liquidator is subsequently appointed to the Singaporean company. The liquidator brings an unfair preference claim in a superior court in Singapore against the Australian company. The Australian company is given proper notice of the proceeding. The Australian company chooses not to appear before the Singaporean court to defend the proceedings. The Singaporean court enters a default judgment against the Australian company.

Will the default judgment be recognised in Australia? If so, which of the four avenues discussed in Sections 8.1 to 8.4 above would you recommend the liquidator pursue in seeking recognition of the judgment in Australia?

Commentary and Feedback on Self-Assessment Exercise 7

Yes, the default judgment will be recognised in Australia under the Foreign Judgments Act, as it is an *in personam* monetary judgment of a superior court in one of the nominated jurisdictions. The recognition of the Singaporean judgment would not be set aside on an application of the Australian company, because the Singaporean court had jurisdiction over the Australian company under s 7(3)(a)(v): the Australian company was the defendant in proceedings in respect of a transaction effected through the Australian company's Singaporean office.

The Foreign Judgments Act should be recommended to the liquidator as it is by far the simplest path to recognition of this foreign judgment.

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