GUIDE TO RESTRUCTURING, TURNAROUND AND INSOLVENCY IN ASIA PACIFIC

OCTOBER 2018

Introduction

Welcome to the second edition of the Herbert Smith Freehills Guide to Restructuring, Turnaround and Insolvency, Asia Pacific

The guide provides an overview of the legal framework for corporate restructuring, turnaround and insolvency in 18 major jurisdictions across Asia Pacific and addresses the key questions commonly asked when dealing with distressed corporations in those jurisdictions.

Increasing interest from investors in the sub-continental belt (including Bangladesh, Myanmar, Pakistan and Sri Lanka) has resulted in increased movement and demand for legislative changes. This edition of the guide includes four new chapters addressing the changing restructuring, turnaround and insolvency landscape in these jurisdictions.

In addition, the layout of the guide has been enhanced to include a snapshot at the beginning of each chapter, and diagrams throughout that detail the intricacies of the diverse legal regimes in Asia Pacific.

Finally, each chapter now includes on-the-ground insight into the recent trends and developments in each jurisdiction, as well as:

- a summary of each of the key formal restructuring and insolvency procedures;
- the methods by which secured creditors can enforce their security;
- common issues encountered in the lead up to a formal insolvency procedure, such as insolvent trading issues, statutory clawback, and lender and director liability;
- priority of distributions in insolvency;
- the prevalence of restructuring techniques such as credit bidding, pre-packaged sales and debt for equity swaps, as well as the ability of creditors to engage in debt trading; and
- the recognition of foreign restructuring and insolvency procedures.

We would like to acknowledge and thank all contributors for helping to update this guide. Their details are found at the end of each relevant chapter.

Herbert Smith Freehills also publishes several other well-regarded guides, including "Guide to Lending and Taking Security in Asia Pacific" (available on request), "Asia Pacific M&A Review 2017", "Guide to Dispute Resolution in Asia Pacific", "Doing Business in Australia Guide 2018" and others. For a full list of guides published by Herbert Smith Freehills, please contact us at asia.publications@hsf.com.

Should you have any questions relating to this guide or restructuring, turnaround and insolvency in Asia Pacific, please contact us or the authors of the individual chapters of this guide.

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Notes, Methodology and Sources

Sources for Chart 1

The rankings in Chart 1 are based on the outcomes in the "Time (years)" and "Recovery rate (cents on the dollar)" under the criteria "Resolving insolvency (rank)" as set out in the 15th edition of the World Bank Group Flagship Report titled '*Doing Business 2018 – Reforming to Create Jobs*'.

Methodology for Chart 2

The ranking in Chart 2 is based on the following criteria:

1. Does the jurisdiction have a corporate receivership procedure? Yes = 0 debtor friendly points; No = 1 debtor friendly point
2. Does the jurisdiction have a "Debtor in possession" reorganisation procedure (other than a UK-style scheme of arrangement)? Yes = 1 debtor friendly point; No = 0 debtor friendly points
3. In the jurisdiction's reorganisation procedure, is there:
   a) an automatic moratorium on secured and/or unsecured creditors? Yes = 2 debtor friendly points
   b) an "on court application" moratorium on secured and/or unsecured creditors? Yes = 1 debtor friendly point
   c) none of the above? Yes = 0 debtor friendly points
4. Can creditors initiate liquidation of a company, without any court involvement? Yes = 0 debtor friendly points; No = 1 debtor friendly point
5. Can creditors initiate a reorganisation procedure, without any debtor involvement? Yes = 0 debtor friendly points; No = 1 debtor friendly point
6. Can creditors replace the liquidator or administrator, without court involvement? Yes = 0 debtor friendly points; No = 1 debtor friendly point
7. Is enforcement by offshore creditors restricted or limited in any way? Yes = 1 debtor friendly point; No = 0 debtor friendly points
8. Can secured creditors enforce their security without resort to the courts (other than a privately appointed receivership)? Yes = 0 debtor friendly points; No = 1 debtor friendly point
9. Are ipso facto clauses unenforceable? Yes = 1 debtor friendly point; No = 0 debtor friendly points
10. Is there the concept of floating or general security over all assets of a company? Yes = 0 debtor friendly points; No = 1 debtor friendly point

Notes on chapter overviews

The GDP for each jurisdiction set out in each chapter in this guide is based on the latest figures held by the World Bank.

The population for each jurisdiction set out in each chapter in this guide is based on the latest figures held by the World Bank.

On the first page of each chapter in the guide, we have provided a snapshot of the jurisdiction. In the Overview table:

- As to 'Type', we have classified the restructuring and insolvency procedures in that jurisdiction as either: (1) Reorganisation; (2) Receivership; or (3) Liquidation.
- As to 'Control', we have classified the restructuring and insolvency procedures in that jurisdiction as either: (1) External administration; or (2) Debtor in possession.
- In relation to 'Moratorium', we have described the restructuring and insolvency procedures as:
  1. Automatic – This means the moratorium occurs automatically upon the commencement of the relevant procedure.
  2. On application – This means the moratorium only occurs upon an application to the relevant courts (or equivalent).
  3. Narrow – In general terms, this means the moratorium prevents court proceedings against the company, or attachment or execution against the company's property; however it does not generally prevent secured creditors from taking enforcement action, landlords taking possession of property nor other parties issuing demands to the company.
  4. Broad – In general terms, this means the stay prevents winding up proceedings, secured parties from taking enforcement action, landlords taking possession of property and court enforcement proceedings.

The World Bank key insolvency indicators set out on the first page of each chapter in this guide are based on responses to "Recovery rate (cents on the dollar)", "Time (years)" and "Strength of insolvency framework (0-16)" under the criteria "Resolving insolvency (rank)" as set out in the 15th edition of the World Bank Group Flagship Report titled '*Doing Business 2018 – Reforming to Create Jobs*'.

Australia

Herbert Smith Freehills

> 'Australia has well established and flexible restructuring and insolvency procedures.'
> **PAUL APÁTHY, HERBERT SMITH FREEHILLS**

Overview of Australian procedures

NAME	TYPE	CONTROL	MORATORIUM	INITIATION
Administration	Reorganisation	External administration	Automatic	Directors, securityholder
Scheme of arrangement	Reorganisation	Debtor in possession	On application	Directors, creditors
Receivership	Receivership	External administration	None	Securityholder
Liquidation	Liquidation	External administration	Automatic	Shareholders, company, creditors

World Bank key insolvency indicators

Recovery Rate (cents on dollar)	Time (years)	Strength of insolvency framework (0-16)
82.5	1	11

Cross-border insolvency

UNCITRAL Model Law	JIN Guidelines
✓	✓

Need to know

- Creditor-friendly
- Insolvent trading risk
- Safe harbour and *ipso facto* reforms

Key Legislation

Corporations Act 2001 (Cth)

Most Recent Law Reform

Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Act 2017 (Cth)

Insolvency Law Reform Act 2016 (Cth)

Overview

Australia has a comprehensive legal regime relating to restructuring and insolvency, predominantly contained in the *Corporations Act 2001* (Cth) ("**Corporations Act**").

The most commonly used restructuring and insolvency procedures in Australia are:

- administrations, which may result in a company executing a deed of company arrangement ("**DOCA**");
- schemes of arrangement;
- receiverships; and
- liquidations (also known as 'winding ups').

Australia's restructuring and insolvency procedures are generally considered 'creditor-friendly' and focus on protecting, and achieving a better return for, creditors.

There have been a number of major reforms in recent years including the introduction of: (i) an insolvent trading 'safe harbour' and (ii) restrictions on the operation of *ipso facto* clauses in certain circumstances. There has also been the new *Insolvency Law Reform Act 2016* (Cth), which makes extensive changes to the Corporations Act regarding, in particular, the regulation of insolvency practitioners and procedural matters in formal insolvency procedures. See Questions 34 and 35 for further information.

Corporate reorganisation procedures

1. What are the main corporate reorganisation or rescue procedures?

The main corporate reorganisation procedures are: (i) administrations (including DOCAs); and (ii) schemes of arrangement.

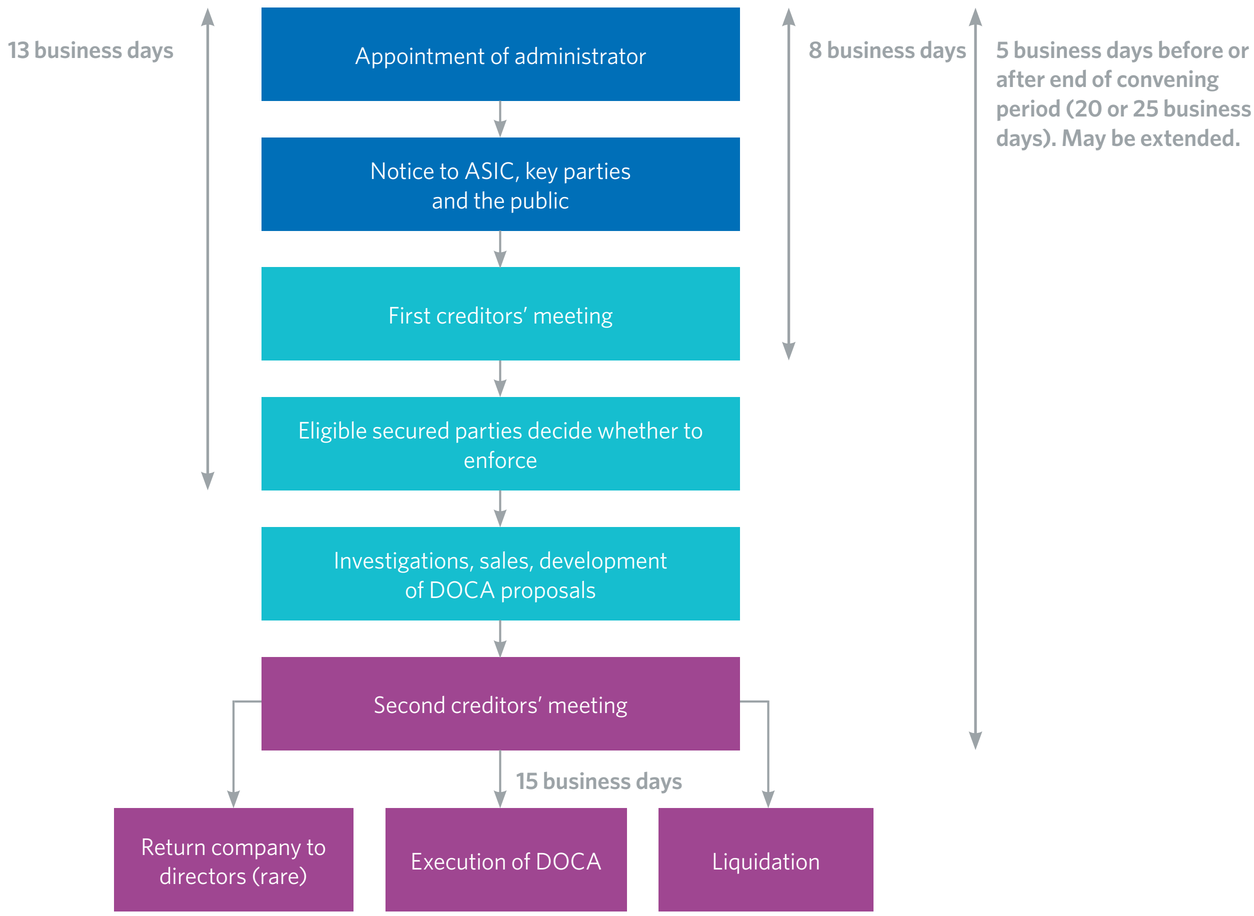
Administration

Overview

Administrations are governed by Part 5.3A of the Corporations Act and are the most common corporate reorganisation procedure in Australia. The process involves the appointment of an external administrator and is designed to resolve a company's future direction quickly. The administrator takes control of the company and its business with the objective of maximising the chances of the company or its business continuing in existence or, if that is not possible, to obtain a better return for the company's creditors and members than would otherwise be the case in the winding up of the company. This may include reorganisation in the form of a DOCA. An overview of administration is illustrated below.

Initiation

The administration of a company commences on the day an administrator is appointed. An administrator may be appointed



by way of written instrument by:

- the company, if the board resolves that the company is, or is likely to become, insolvent (i.e. if it is not able to pay its debts as and when they fall due) and to make such appointment. This is the most common appointment route;
- a liquidator or provisional liquidator, if he or she thinks that the company is, or is likely to become, insolvent; or
- a secured creditor who has an enforceable security interest in the whole, or substantially the whole, of the company's property.

There is no general power of the court to appoint administrators (on the application of creditors or otherwise).

Supervision and control

The administrator has control of the company's business, property and affairs, and has broad powers including the power to carry on, terminate or dispose of the business or any property of the company (subject to the exceptions described under "Business and asset sales" below). In doing so, the administrator acts as the company's agent. If a creditors' committee is appointed at the first creditors' meeting, the committee may, among other things, consult with the administrator and approve the administrator's fees.

The appointment of an administrator, once made, cannot be revoked, although an administrator may be removed by the creditors at the first meeting convened, or by the court, where such a removal would be for the better conduct of the administration. There is limited, and in some instances no, court involvement in an administration, although applications can be made to the court during the course of the administration. Only registered liquidators may be appointed as administrators (who are subject to ASIC oversight and regulation).

Stages and timing

The two main stages of an administration are the first and second meetings of creditors.

Two issues are determined at the first meeting: (i) whether the administrator should be replaced; and (ii) whether a creditors' committee should be appointed (and if so, who are its members).

The second meeting of creditors is the time at which the company's future is decided. The possible outcomes for the company are: (i) it enters into a DOCA, (ii) it enters liquidation; or (iii) it is returned to the control of the directors (rare).

It is common for the period within which the second meeting must be held to be extended by the court upon application by an administrator (sometimes for significantly longer periods), especially in larger or more complex cases. This allows sufficient time for a sale or reorganisation of the business to be developed and implemented.

Typically, most of the 'work' of an administrator happens between the first and second meetings of creditors. This generally involves investigations, running the business, the parties preparing DOCA proposals, and sales of assets.

Moratorium

An automatic stay applies throughout the administration period which prevents:

- the winding up of the company;
- secured parties enforcing security interests;
- lessors or third parties taking possession of leased property or property owned by the third party;
- court or enforcement proceedings against the company or its property; and
- enforcement of guarantees given by a director (or their spouse or relative) in respect of the company.

Depending on the nature of the stay, there are exceptions, including where a creditor obtains leave of the court or the administrator's consent. Exceptions also apply to secured creditors who have taken certain steps to enforce the security prior to the beginning of the administration. A secured creditor with security over the whole, or substantially the whole, of the property of the company may also take enforcement action (including appointing a receiver) within the 'decision period' (being 13 business days from notice of appointment of the administrator).

In addition, the new *ipso facto* regime provides that a contractual right (including a right to terminate the contract) cannot be enforced against a company that has entered administration by reason of:

- the company having entered administration;
- the company's financial position;
- a prescribed reason (none have yet been prescribed); or
- something that is in substance contrary to the above.

This *ipso facto* stay is not intended to restrict a counterparty from enforcing a right for any other reason, such as a breach involving non-payment or non-performance. The *ipso facto* stay does not apply to contracts entered into prior to 1 July 2018, and there are a number of other exceptions, including for certain prescribed types of contracts and rights.

Operation of the business

The administrator has the power to operate the company's business while it is in administration. The company can continue to incur debts and obligations, and sell products and services in the ordinary course of the business, although those acts must be authorised by the administrator.

The administrator is personally liable for debts incurred in performing his or her functions and exercising powers for: (i) services rendered; (ii) goods bought; (iii) property hired, used or occupied; and (iv) repayment of money borrowed (and related costs and interest). However, the administrator is entitled to be indemnified out of the company's property for debts or liabilities incurred in the performance of their functions, and such indemnity is secured by a lien on the company's property. Whilst the lien has priority over unsecured creditors, it generally does not have priority over secured creditors (with the exception of circulating security interests in certain circumstances).

New money funding

The administrator has powers to borrow funds on behalf of the company and is personally liable for such debts, subject to a right to be indemnified out of the assets of the company (see "Operation of the business" above). It is common for administrators to borrow funds on this basis (or by the administrator specifically granting security to the lender) provided the company has sufficient unencumbered assets to support the borrowings.

Business and asset sales

The administrator has the power to dispose of the business and property of the company, with such sale conducted by the administrator (or parties authorised by that person).

The administrator must not dispose of property subject to a security interest, or property of which someone else is the owner or lessor, unless: (i) the disposal is in the ordinary course of the company's business; (ii) the written consent of the secured party, owner or lessor has been obtained; or (iii) leave of the court has been granted. The administrator must act reasonably in exercising a power of sale in such circumstances. Any net proceeds from the sale of property the subject of a valid security interest must first be applied to any debts secured by that security interest. The purchaser will acquire the assets free of existing claims and security.

Implementation of a reorganisation or restructuring 'plan'

Before the second meeting of creditors, any person may propose a reorganisation by way of a DOCA in respect of the company and its creditors. A DOCA is a binding agreement between a company and its creditors that sets out how the company's affairs will be dealt with following administration. A DOCA may provide for things such as a compromise or rescheduling of creditor claims, a further moratorium, a debt for equity swap, a sale of some or all of the company's assets, payment to creditors or the creation of a creditors' trust. It may be proposed by an interested party; often the directors, members or a proposed purchaser of the company's business or assets.

Whilst there are few restrictions on what can be proposed in a DOCA, it must provide for a better return to creditors than would otherwise be available in a liquidation. It may provide for a different outcome among different classes of creditor, provided there is a legitimate business reason to do so. The rights of secured creditors, owners and lessors of property will not in general be affected by a DOCA unless they voted in its favour or the court so orders (although this principle has been undermined to some extent by recent case law).

The administrator will consider the DOCA proposal and prepare a report to the creditors, including his or her opinion as to whether it would be in the creditors' interests to execute the DOCA. The creditors vote on whether the company should enter into the DOCA at the second meeting of creditors. The DOCA will be approved if a majority of the creditors (by value and number) present and voting at the meeting vote in favour of the resolution. If approved, the administrator must then prepare the DOCA, which must be executed within 15 business days after the end of the second meeting.

If the DOCA is approved, the administrator will be the deed administrator, unless the creditors, by resolution passed at the meeting, appoint someone else. Once executed, the DOCA binds the company, its officers and members, the deed administrators, and all creditors (subject to the comments above in respect of secured creditors, owners and lessors), insofar as the creditors' claims arose on or before the day specified in the deed.

Effect on stakeholders

The powers of directors and officers are suspended upon the appointment of an administrator. Employees continue in employment unless terminated by the administrator. Members are not able to transfer their shares in a company under administration (subject to certain exceptions).

See "Moratorium" above regarding the new *ipso facto* regime.

End of procedure

An administration will typically end shortly after the second meeting of creditors, at which the creditors vote on whether the company should: (i) enter into a DOCA; (ii) enter liquidation; or (iii) be returned to the control of the directors (rare).

A company will no longer be subject to a DOCA upon its termination. This is normally by reason of the occurrence of circumstances specified in the DOCA which result in termination, but a company can remain so subject by order of the court, by resolution of the creditors, or by notice given by the deed administrators, depending on the circumstances.

Schemes of arrangement

Overview

Schemes of arrangement in Australia may be: (i) creditors' schemes, i.e. schemes affecting the rights of creditors of a company; or (ii) members' schemes, i.e. schemes affecting the rights of members (shareholders) of a company. In this part, we will only discuss creditors' schemes (and "scheme" and "scheme of arrangement" shall refer to a creditors' scheme of arrangement accordingly).

A scheme of arrangement is a court approved compromise or arrangement between a company and its creditors (or any class of creditors). The process is governed by Part 5.1 of the Corporations Act.

A scheme is not strictly an insolvency process, and the company's directors remain in control of the company throughout the process, although an external officeholder known as the scheme administrator may sometimes be appointed to assist in the scheme process. That said, a scheme can also be undertaken by a company that is in a formal insolvency or liquidation process.

Whilst the use of schemes of arrangement in Australia has been and remains less frequent than DOCAs, there has been an increased use of schemes since the global financial crisis in connection with large and complex financial restructurings.

Initiation and stages

A scheme of arrangement is usually proposed by a company to its creditors (or to one or more classes of its creditors). The process involves the following steps (and indicative timing):

Notice to ASIC
ASIC must have a reasonable opportunity to consider the terms of the scheme (including the explanatory statement) and make submissions to the court

↓ 14 to 21 days

First court hearing
Application for an order to convene a meeting of a class or classes of creditors to vote on the scheme

↓ 21 to 28 days

Meeting of creditors
Creditors (or classes thereof) vote on the scheme

↓ 3 to 5 days

Second court hearing
The court considers whether to approve the scheme

↓ Same or next day

Scheme takes effect
Court orders are lodged with ASIC and the scheme becomes effective

↓ 0 to 7 days

Scheme is implemented

The time to effect a scheme of arrangement can vary significantly depending on the complexity of the restructuring. However, they typically take between 4-6 months (or longer) to negotiate, document and implement.

Approval and implementation

For a scheme of arrangement to be approved:

- a majority in number; and
- at least 75% by value,

of creditors (or creditors of each class) present and voting (in person or by proxy) at the meeting of creditors (or of each class thereof) must vote in favour of the scheme.

> **A scheme must be approved by:**
>
> - a majority in number; and
> - 75% by value,
>
> of creditors (or classes thereof), present and voting.

If the creditors vote in favour of the scheme, a further application must be made to the court to approve the scheme. The court may grant its approval subject to such alterations or conditions as it deems fit. After the court has approved the scheme, it takes effect in accordance with its terms once the court orders approving the scheme are lodged with ASIC.

Schemes can be used to bind secured creditors if the secured creditors are included as part of the scheme.

Supervision, control and operation of the business

Whilst a compromise or arrangement is being proposed, the directors and officers continue to have control over the company and the process. Typically the scheme itself will have little impact on the operation of the business, as it generally relates only to a compromise or arrangement in respect of the company's financial debt. It is usually the case that a company's other creditors, such as trade creditors, are not affected and do not have their rights compromised by the scheme of arrangement.

New money funding

In the period while the scheme is proposed and executed, the company can continue to borrow money and grant security in the normal manner.

Moratorium

There is no automatic moratorium when a scheme of arrangement is proposed. However, where a scheme has been proposed, an application may be made to the court to restrain further legal proceedings against the company.

The new *ipso facto* regime provides that a contractual right (including a right to terminate the contract) cannot be enforced against a company that has proposed a scheme of arrangement (that is to avoid insolvent liquidation) by reason of:

- the company having publicly announced that it will apply for such a scheme;
- the company being subject to an application in respect of such a scheme;
- the company being subject to such a scheme that has been approved;
- the company's financial position if it is subject to such an announcement, application or scheme;
- a prescribed reason (none have yet been prescribed); or
- something that is in substance contrary to the above.

This *ipso facto* stay is not intended to restrict a counterparty from enforcing a right for any other reason, such as a breach involving non-payment or non-performance. The *ipso facto* stay does not apply to contracts entered into prior to 1 July 2018, and there are a number of other exceptions, including for certain prescribed types of contracts and rights.

Corporate liquidation procedures

2. What are the main (insolvent) corporate liquidation procedures?

An insolvent company may be liquidated through: (i) compulsory liquidation; or (ii) a creditors' voluntary liquidation. In Australia, the terms 'liquidation' and 'winding up' are used interchangeably.

Compulsory liquidation and creditors' voluntary liquidation

Overview

Compulsory liquidation (where the court orders the winding up of the company) and creditors' voluntary liquidation (where the shareholders vote for the insolvent company to be liquidated) are governed by the Corporations Act. They are commonly used in Australia where an insolvent company is to be wound up, and involve the appointment of an external officeholder (the liquidator) to the company. The objective of a liquidation is to collect the company's assets, realise them and distribute the proceeds to creditors (in the priority prescribed by the Corporations Act) in an orderly manner. A liquidator also has broad powers to investigate the company's affairs and to challenge certain pre-liquidation transactions. Creditors' voluntary liquidations are more common than compulsory liquidations.

Initiation

Compulsory liquidation

Compulsory liquidation is initiated by an application to the court for an order that the company be wound up. Such an application may be made by various persons, including the company and its members, but is most often made by a creditor. There are a number of bases upon which a court may make an order to wind up a company, the most common of which is because the company is insolvent. Failure to comply with a statutory demand (being a demand served on a company by a creditor requiring payment of a debt within 21 days of service) is a ground upon which a company is presumed insolvent.

Creditors' voluntary liquidation

A creditors' voluntary liquidation arises:

- where members of a company resolve to wind it up and there is no declaration of solvency made by the directors;
- if the members resolve to wind up the company by way of a members' (solvent) voluntary liquidation (involving a solvency statement by the directors and statement of affairs of the company), but the appointed liquidator later finds that the company is in fact insolvent. The liquidator may apply for the liquidation to proceed as a creditors' (insolvent) voluntary liquidation; or
- following an administration, if the creditors resolve at the second meeting of creditors that the company be wound up or the DOCA otherwise fails. It is usual in such instances for the administrator to become the liquidator.

Supervision and control

The liquidator supervises and controls the liquidation. The court has little or no involvement, unless applications are made during the course of the procedure, or the court appointed the liquidator.

The creditors are able to replace the liquidator at a meeting of creditors with another liquidator. The court may also, in appropriate circumstances, remove a liquidator and appoint another.

The liquidator has extensive powers, including the power to do all such things necessary for the winding up of the company, pay creditors or make compromises or arrangements with creditors, and sell property, although depending on the circumstances and the particular power to be exercised, the approval of the court, the committee of inspection, or a creditors' resolution may be required. The liquidator also has the power to disclaim onerous property, including contracts.

At a meeting of creditors, a committee of inspection may be appointed. A committee can assist the liquidator, approve his or her remuneration and make directions to the liquidator (although the liquidator is not bound by those directions). Liquidators must be registered, and are subject to ASIC oversight and regulation.

Stages and timing

In a compulsory liquidation, an application for a company to be wound up is to be determined within 6 months (or such time as extended by the court) after it is made. Once the court orders a company to be wound up, a liquidator is appointed.

In a creditors' voluntary liquidation, the creditors' meeting must be convened within 11 days after the resolution was made by members to wind the company up. Creditors must be given at least 7 days' notice of the meeting, and must receive a summary of the company's affairs, a statement of its assets and liabilities, and details about its creditors.

Following his or her appointment, the liquidator will take control of the company's assets, obtain its books and records, investigate the affairs of the company with the objective of collecting and realising assets, and deal with the company's creditors. The liquidator has regular reporting obligations to ASIC, and will hold creditors' meetings from time to time. The timing of a liquidation depends on a number of factors, including the complexity of the liquidation, the investigations into the company's affairs, and the length of any proceedings commenced against any third parties, but can continue for a number of years in some instances.

A creditor must file a proof of debt with the liquidator for any debts or claims owing by the company to be entitled to receive distributions made by the liquidator. The liquidator must either admit or reject the debt (or part of it). Normally, liquidators pay any dividends towards the end of the liquidation process. Secured creditors are not entitled to prove for their secured debt except under certain circumstances, such as where a secured creditor surrenders the security interest for the benefit of creditors generally.

In a creditors' voluntary winding up, there must be a final meeting of creditors and members before the company is deregistered.

Moratorium

Except with leave of the court (and on such terms as the court thinks fit to impose), a stay automatically applies throughout the period of the liquidation that prevents:

- court proceedings against the company; or
- attachment or execution against the company's property.

The stay does not prevent:

- secured creditors from enforcing their security interests;
- landlords or owners of property from taking possession of such property; or

- counterparties from exercising contractual rights to terminate a contract, accelerate debt or make demands for payment.

The *ipso facto* stay generally does not apply to liquidations.

> Liquidation does not prevent secured creditors from enforcement.

Operation of the business

It is normal for the business of the company to be shut down upon or prior to the commencement of the liquidation. The liquidator's powers (see "Supervision and control" above) include the power to carry on the business of the company, provided it is necessary for the beneficial disposal or winding up of the business. In doing so, the liquidator may incur debts, obligations and sell products and services.

Costs and expenses incurred by the liquidator in carrying on the business will receive priority over unsecured creditors and preferential creditors in any distribution made. Generally speaking, in the absence of misconduct, personal liability does not attach to the liquidator for acts and transactions performed or entered into in his or her capacity as agent for the company.

New money funding

The liquidator's powers (see "Supervision and control" above) include the power to obtain credit (including on the security of the company's property). It is possible for the liquidator to be funded by a creditor to undertake investigations or bring proceedings against another creditor, although that possibility depends on, among other things, the assets that may be recoverable to benefit the funding creditor.

The liquidator will not generally be personally liable for acts and transactions entered into in his or her capacity as agent for the company (including the borrowing of funds), although if there is such a risk, the liquidator may require an indemnity from the persons providing credit. If a liquidator borrows against the security of company property, such security is subject to the rights of existing secured creditors. However, the court has the power to make orders in favour of certain creditors who have assumed a risk in giving certain indemnities to a liquidator, giving those creditors an advantage in the distribution of the company's property in consideration of the risk assumed by them.

Business and asset sales

The liquidator will conduct a sale of the business and assets of the company with a view to benefiting the creditors. The liquidator is at liberty to choose the nature of the sale, and does not need creditor or court approval, but in doing so, the liquidator is required to exercise due care and diligence. Except as noted below in relation to the sale of secured property and payments statutorily preferred, sale proceeds form part of the assets of the company available for distribution to the company's creditors (see Questions 10 to 12 below).

If the liquidator sells secured property, the secured creditor will be entitled to be repaid from the proceeds of any sale in priority to other creditors. The liquidator does not have the power to sell assets free and clear of security (unless the security has vested, as discussed below).

Effect on stakeholders

Directors' and officers' powers are suspended upon the winding up of a company. Whilst employees are not automatically terminated upon the commencement of a liquidation, typically, most employees will be terminated by the liquidator shortly thereafter. The liquidator, however, may retain key employees to assist in the winding up. Subject to certain exceptions, members are not able to transfer their shares following the winding up of a company.

Contracts do not automatically terminate upon the appointment of a liquidator, although counterparties may have a right to terminate upon such an appointment. The liquidator is generally not obliged to cause the company to perform any pre-existing contracts, and has the power to disclaim unprofitable contracts.

End of procedure

The deregistration of a liquidated company signifies the end of the liquidation and the end of the company. It is not possible for the company to survive liquidation.

Corporate receivership procedures

3. Is there a corporate receivership procedure for security enforcement?

Receivership

Overview

Secured creditors are entitled to (and commonly do) appoint external officeholders, referred to as 'receivers', to take possession of and sell the secured property for the purpose of repaying the secured creditor. A 'receiver and manager' will also have broad powers to manage the business whilst appointed, and will generally seek to sell the company's business as a 'going concern'.

Receiverships are governed by Part 5.2 of the Corporations Act together with the security agreement between the company and the secured party, which will normally specify the secured creditors' right to appoint the receiver and the powers of the receiver once appointed.

This section discusses privately appointed receivers only. The courts also have the power in certain situations to appoint receivers, but this is rarely done in practice.

Appointment

A security agreement will typically grant the secured party the right to appoint a receiver in respect of the secured property once the security becomes enforceable (generally following the occurrence of an 'event of default'). The appointment is made by way of a deed of appointment entered into between the secured party and the receiver. Receivers usually also require an indemnity from the secured creditor in respect of costs and liabilities incurred in the conduct of the receivership.

If an administrator has been appointed to a company, a receiver may still be appointed if: (i) the secured party has security over the whole, or substantially the whole, of the property of the company; and (ii) the secured party makes the appointment during the decision period (generally within 13 business days of the administrator's appointment).

Supervision and control

Generally, there is little court oversight of receivers, although a court does have powers upon application to remove a receiver, fix a receiver's remuneration, and give directions to the receiver in relation to matters arising out of the receivership.

The powers of the receiver are contained in both the Corporations Act and the security agreement pursuant to which he or she was appointed. The powers set out in the Corporations Act are extensive, and include the power to take control of and dispose of the secured property, borrow money on the security of property, carry on the business, and bring or defend proceedings on behalf of the company, although those powers are to be used for the purpose of attaining the objectives for which the receiver was appointed.

Moratorium

There is no automatic stay or moratorium against creditor claims in a receivership. However, if an administrator is also appointed to the company, the administration moratorium will apply (see "Administration" in Question 1 above), which the receiver can effectively benefit from. The new *ipso facto* regime provides that a contractual right (including a right to terminate the contract) cannot be enforced against a company, where a receiver has been appointed to the whole or substantially the whole of the company's property, by reason of:

- the appointment of the receiver;
- the company's financial position;
- a prescribed reason (none have yet been prescribed); or
- something that is in substance contrary to the above.

This *ipso facto* stay is not intended to restrict a counterparty from enforcing a right for any other reason, such as a breach involving non-payment or non-performance. The *ipso facto* stay does not apply to contracts entered into prior to 1 July 2018, and there are a number of other exceptions, including for certain prescribed types of contracts and rights.

Operation of the business

It is usual for the receiver to operate the business of the company during the receivership provided the receiver has been appointed over all the assets of the company (and the security agreement does not limit the receiver's power to do so).

The receiver can continue to incur debts and obligations for the purposes of realising the assets, but will be personally liable for debts incurred in the course of the receivership for: (i) services rendered; (ii) goods bought; or (iii) property hired, used or occupied. The receiver will also be personally liable for rent under pre-existing contracts that is attributable to the period beginning 7 days after the appointment for so long as the company continues to use the property (or the receiver remains appointed). The receiver is entitled to be indemnified from the secured property in respect of such debts incurred (together with any other costs and expenses) and such amounts are generally entitled to be paid to the receiver in priority to moneys owing to the secured creditor (i.e. effectively giving such debts priority to the secured creditor). The receiver is usually not permitted to deal with assets of the company unless they are subject to the security created by the relevant security agreement.

New money funding

The receiver will normally have the power to borrow money secured against the property of the company, and grant options over property on such conditions as the receiver thinks fit, but those powers must be exercised for the purpose of attaining the objectives for which the receiver was appointed. The receiver will be personally liable for repayment of such amounts, but the receiver will be entitled to be indemnified for such amounts from the secured property ahead of the secured party (therefore effectively giving the lender of additional funds priority to the amounts owing to the secured creditor).

Business and asset sales

The receiver has the power to sell the secured property (and related business) over which they are appointed. Whilst creditor or court approval is not required to undertake the sale, the receiver sells the property as agent of the company and therefore generally does not have the power to release any security over the assets being sold (this must be done by the applicable secured creditor).

A receiver has a statutory obligation to take all reasonable care to sell the property at market value (or if the property does not have a market value, for the best price reasonably obtainable, having regard to the circumstances existing when the property is sold).

Sale proceeds are applied according to the security agreement under which the receiver was appointed, but will normally provide for payment of the receiver's costs, expenses and remuneration first, then repayment of the secured debt. Any surplus must be paid back to the company. The security agreement will usually make provision for release of the security upon repayment of the outstanding debt to the secured party.

Effect on stakeholders

The mere appointment of a receiver does not terminate a contract, nor does it suspend the powers of the directors and officers. Receivers have the power under the Corporations Act to engage or discharge employees in attaining the objectives for which the receiver was appointed. Shareholders are generally unaffected by a receivership in that there is no moratorium or stay on the transfer of shares. As noted in "Moratorium" above, the *ipso facto* law reform prevents the termination of contracts upon the occurrence of certain receiverships.

Relationship with other insolvency procedures

It is common for a receivership to co-exist alongside an administration or liquidation. The receiver generally has the power to continue to sell the secured assets and operate the business if an administrator has also been appointed. If a liquidator is appointed following the appointment of a receiver, the receiver can carry on the company's business with the approval of the court or the liquidator.

Special procedures

4. Are there insolvency procedures specific to particular industries?

Yes, insolvencies of the following entities (among others) are governed by specific procedures:

- life insurance companies and insurance companies are regulated by the *Life Insurance Act 1995* (Cth) and the *Insurance Act 1973* (Cth) respectively, which provide for the winding up and judicial management of such companies in the event of insolvency. See Question 35 regarding reforms;

- banks and other authorised deposit-taking institutions are regulated under the *Banking Act 1959* (Cth) by the Australian Prudential Regulation Authority ("**APRA**"). APRA has broad powers to direct the restructuring of bank operations, appoint a statutory manager and apply to the Federal Court of Australia for its winding up. A liquidator also has specific powers in relation to payments to depositors under the financial claims scheme. See Question 35 regarding reforms; and
- co-operatives and associations (common in the not-for-profit sector) are generally governed by the Co-operatives National Law, however a few remaining states are yet to adopt this legislation.

Security

5. What are the main types of security, and what assets can security be taken over?

In Australia, most land ownership is governed by the Torrens title system and security is generally taken by way of a registered mortgage over the freehold or leasehold interest in the land. Registration is not mandatory and a failure to register the mortgage will generally not affect the validity of security as against the grantor. However, registered interests generally have priority over unregistered and subsequently registered interests, and failure to register may lead to postponement and potentially extinguishment of the secured party's interest.

Security over personal property (including goods and chattels, inventory, shares and other investment instruments, bank accounts and intellectual property) typically constitute 'security interests' for the purposes of the *Personal Properties Securities Act 2009* (Cth) ("**PPSA**"). As a general rule such security interests must be perfected either by: (i) the secured party taking possession or control of the collateral; or (ii) the secured party registering such security interests with the Personal Property Securities Register ("**PPSR**"), within the relevant time periods. Failure to perfect the security can void the security interest upon the formal insolvency of the grantor. The timing of any perfection (or failure to do so) can also affect the secured party's priority in respect of other security interests.

For more information on taking and enforcing security in Australia, see the Herbert Smith Freehills' Guide to Lending and Taking Security in Asia Pacific.

6. Is it possible to take floating or general security over all of the present and after acquired property of a company (and is this common)?

Yes. It is common practice for security to be granted in the form of a 'general security agreement' under which a PPSA security interest is granted over all of the present and after acquired personal property of the company; and a charge or mortgage is granted over any other (non-personal) property, such as real estate.

Security enforcement

7. What are the main methods of enforcing security?

Receivership

Receivership is one of the main methods of enforcing security (see Question 3 above).

Mortgagee in possession

If a mortgage has been granted over property, and the mortgagor has defaulted under the mortgage, the mortgagee may be entitled to exercise its powers, which may include taking possession of the property and exercising its powers of sale. Notice must be given to the company, and time must be given for the company to satisfy the demand, before powers of possession can be exercised. This is a self-help method where no court approval is required, and the powers of enforcement arise by virtue of the mortgage documents.

Normally, the mortgagee appoints an agent to enter into possession of the property and sell it. The mortgagee has a duty under the Corporations Act to take reasonable care to sell the property for not less than market value (or if the property does not have a market value, for the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold). The mortgagee also has general law duties to act in good faith in relation to the sale.

8. With respect to share security, is it possible for the secured creditor or an appointee to exercise the voting power of the shares?

Yes. It is common for security over shares to allow the secured creditor to exercise the voting powers of the shareholder to approve transactions, replace directors or otherwise influence the operation of the company once the security becomes enforceable.

Trade and unsecured creditors

9. What forms of security or quasi-security are asserted by trade creditors or suppliers?

Retention of title arrangements are common in supply agreements in Australia. However, under the PPSA retention of title arrangements are classified as security interests and therefore need to be 'perfected' (generally by a valid PPSR registration) in order to be enforceable in a formal insolvency of the company.

Trade creditors are also sometimes able to rely on liens that arise at law (although these are not particularly common in practice). Contractual liens are treated as security interests under the PPSA, and therefore need to be perfected (by possession or valid registration on the PPSR) to be enforceable in a formal insolvency.

10. What are the main remedies and enforcement actions available to unsecured creditors for unpaid debts?

The main remedies and enforcement actions available to unsecured creditors in respect of unpaid debts include:

- issuing proceedings in the appropriate court seeking an order for repayment of the debt. Following judgment, a creditor may seek to use a number of enforcement processes. These include applying to a court for a warrant of seizure and sale, an order for attachment of debts (where a debt owing to the company is first applied towards the judgment debt in favour of the creditor), and an order for attachment of earnings (similar to an attachment of debts, although in respect of earnings of the company); and
- issuing a statutory demand. If the debtor is a corporation, and the judgment debt exceeds A$2,000, a statutory demand

may be issued against the company. If the judgment debtor fails to respond to the statutory demand within a prescribed period, it will be deemed to be insolvent and the judgment creditor can seek to wind up the company.

These actions will be curtailed upon the appointment of an administrator or a liquidator by reason of the moratorium on creditor claims upon such an appointment (see "Moratorium" in the Administration section in Question 1).

Insolvency distributions and priorities

11. When are distributions made to secured and unsecured creditors in reorganisations and liquidations?

Liquidators have the power under the Corporations Act to make distributions to secured and unsecured creditors. Distributions can be made as interim and final dividends, as and when the liquidator decides.

Distributions are not made in administrations, unless a DOCA is entered into which results in a distribution to creditors (often at a substantially lower amount than the value of their debt).

Receivers will only make distributions to the secured creditor which appointed them, and any surplus will be paid back to the company.

12. What is the priority regime for distributions in an insolvency?

Generally, the order of distributions in a winding up is as follows:

- costs and expenses associated with the external administration;
- employee entitlements, including wages, superannuation, leave entitlements and retrenchment pay;
- unsecured creditors on a *pari passu* basis.

The proceeds of secured property will generally be applied separately in satisfaction of the secured debt (provided that the proceeds of a circulating security interest must be used to pay certain debts ahead of the secured creditor), with any surplus being distributed in the order set out above if the company is in liquidation.

13. Are there any classes of unsecured creditors that have preferential treatment in a reorganisation or liquidation?

Yes. Employee entitlements (including wages, superannuation entitlements and injury compensation) receive preferential treatment over other unsecured creditors. Where the property of a company is insufficient to meet these payments (except for injury compensation), payment must be made to employees entitled to them in priority over the claims of a secured party in relation to a circulating security interest. There are also provisions granting priority to proceeds of contracts of insurance for a liability incurred by the company at a certain time.

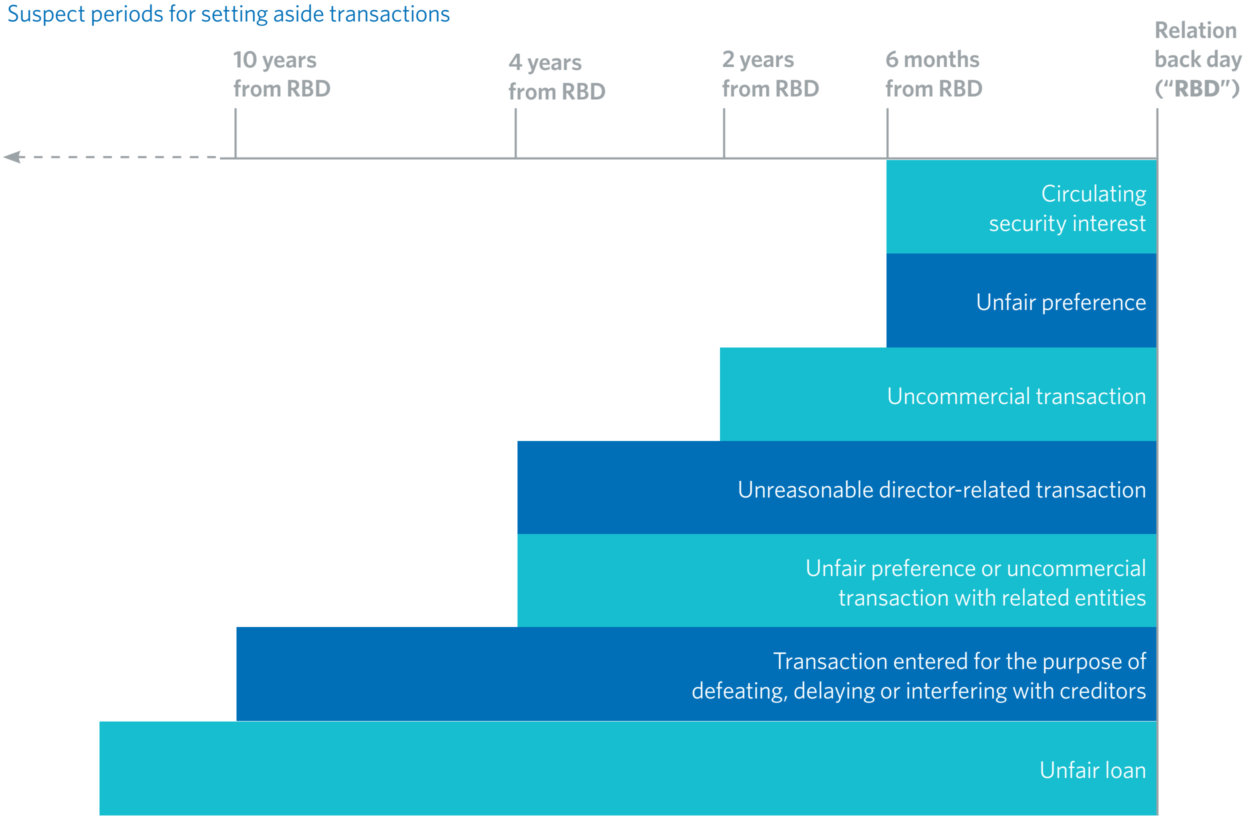
Setting aside pre-insolvency transactions

14. What transactions can be set aside in a reorganisation or liquidation?

A liquidator may apply to the court to set aside the following transactions occurring prior to a liquidation:

- ***unfair preference***, being a transaction between the company and a third party which results in the third party receiving from the company more in respect of an unsecured debt than

Suspect periods for setting aside transactions



it would receive in respect of such debt if the transaction were set aside and the third party were to prove for the debt in a winding up of the company;

- ***uncommercial transaction***, being a transaction that a reasonable person in the company's circumstances would not have entered into, having regard to the relevant benefits and detriments of entering into it, and any other relevant matter. Generally, uncommercial transactions are those where the company's assets are sold at an undervalue;
- ***unfair loan***, being a loan where the interest or charges are extortionate;
- ***unreasonable director-related transaction***, being a transaction where a director (or his or her close associate) has/have received a benefit from the company where, having regard to the benefits and detriments of the transaction (and any other relevant matter), a reasonable person in the company's circumstances would not have entered into the transaction; and
- ***transaction to defeat creditors***, being a transaction entered into by the company for the purpose of defeating, delaying or interfering with the rights of any or all of its creditors.

In addition, a circulating security interest created within 6 months of the 'relation back day' (see Question 15 below), will be void against a liquidator except to the extent it secured advances, guarantees, other amounts incurred at the time of or following the granting of that security (unless the company was solvent at the time).

An unfair preference or uncommercial transaction can only be set aside if (among other things) the company was insolvent at the time it was entered into or at the time an act is done or omission is made for the purpose of giving effect to the transaction.

The court has the power to make a number of orders to set aside a transaction, including an order directing a person to pay money, or transfer property back to the company.

Certain defences are available to third parties subject to a claim to set aside a transaction, including what is known as a 'good faith' defence, where the person received the benefit of the transaction in good faith and without actual suspicion of (and no reason to suspect) the insolvency of the company.

15. Is there a 'suspect period' prior to formal insolvency during which transactions may be set aside?

The 'suspect periods' are illustrated on the previous page. The 'relation-back day' is determined by reference to how the company went into external administration (such as the day on which the winding up application was filed, but it can be a different day depending on the circumstances). For example, if the company was in administration immediately before liquidation, the relation-back day would be the date the administration began.

Director liability and compulsory filings

16. Are there circumstances where companies are required to commence insolvency proceedings? What are the consequences of failure to do so?

There are no circumstances in Australia which require a company to commence insolvency proceedings. However, there is a positive duty on directors not to trade a company whilst insolvent, which can 'force the hand' of directors to place the company into administration.

17. Can directors or management be subject to any civil or criminal liability for trading while insolvent or other analogous concepts?

Yes. Australia has some of the strictest insolvent trading laws in the world (which is one of the reasons for recent 'safe harbour' reforms to those laws). If a company incurs a debt whilst insolvent, and there are reasonable grounds for the director to suspect the company either is or would become insolvent by incurring that debt (in isolation or with other debts at that time), the director can be: (i) personally liable in respect of the debt so incurred (to the extent the applicable creditor suffers loss if the company subsequently enters liquidation); and (ii) subjected to both civil penalty provisions and criminal prosecution (for the latter, only if it can also be established that the director's failure to prevent the company from incurring the debt was dishonest).

The insolvent trading safe harbour is a carve-out for directors from personal liability from insolvent trading arising from certain debts incurred where they start developing one or more courses of action that are reasonably likely to lead to a better outcome for the company. There are a number of additional requirements that must be satisfied for directors to take the benefit of the safe harbour.

Whilst there have been few successful prosecutions of directors for insolvent trading, the risk of insolvent trading claims is a common catalyst for directors to place a company into administration.

18. Do directors owe any duties to creditors once a company is insolvent or in financial distress?

The generally accepted position in Australia is that directors owe their duties to the company to which they are appointed. Accordingly, directors do not owe duties to creditors.

Directors are required to consider the interests of creditors in the 'twilight zone'. This is the time during which the company is in or is nearing insolvency, as those interests are directly relevant to the interests of the company. Furthermore, the precise ambit of directors' duties in such circumstances continues to be subject to some debate in Australia following the *Bell Group* decision where it was suggested that directors must go beyond mere consideration of creditors' interests and ensure that creditors' interests are properly protected. In that case it was held that one group of creditors should not have been preferred through the granting of security at the expense of the rest.

Creditors do not have a directly enforceable right against directors for a breach of directors' duties or for the debt claimed by the creditor against the distressed company. However, an action for breach of the duty can be taken by an administrator or liquidator of the company.

Lender liability

19. Is there a concept of 'shadow directorship' that can lead to creditors becoming liable for actions of the company or the directors?

Yes. Section 9 of the Corporations Act provides that a director includes (in addition to a person actually appointed as a director) a person in accordance with whose instructions or wishes the directors of the company are accustomed to act.

However, the mere fact that a person gives advice in the proper performance of functions attaching to that person's professional capacity or business relationship with the directors does not mean that person is a 'shadow director'.

The consequence of a creditor being found to be a shadow director is that the duties imposed by the Corporations Act on directors will also be imposed on that creditor, including the positive duty to prevent insolvent trading, as will any penalties associated with a breach of those duties.

20. Are there any other key liability risks for creditors to consider when engaging with companies and directors in pre-insolvency restructuring negotiations?

Yes. There is some authority in Australia that a creditor may be at risk if they had knowledge of, or deemed to have knowledge of, a breach or potential breach of a director's fiduciary duties when the company transacted with the creditor. The creditor may be at risk of being liable to account for any property disposed of by reason of the breach.

Further risks are those associated with voidable transactions, whereby certain transactions entered into are vulnerable to being set aside by a court, as detailed in the commentary to Question 14 above. Creditors should be aware of the potential clawback, particularly in relation to transactions where there is a loan, security is granted, or where payments are made to the creditor.

Credit bidding

21. Is credit bidding possible?

There is no formal recognition of credit bidding under Australian law.

However, a credit bid can effectively be achieved through transaction structuring in the right circumstances. It is generally possible for a secured creditor to bid for an asset, either directly or indirectly through a newly formed company, being sold through an insolvency process. If the secured creditor has first ranking security over the asset (and it is not a circulating security interest in respect of such asset) then the secured creditor could normally expect that most, if not all, of the sale proceeds would be paid to it from the sale process in satisfaction of the secured debt (for example, costs, expenses and taxes may still need to be deducted). In some circumstances it is possible to structure this money flow to occur without requiring actual cash payments (other than to meet the 'leakage' amounts payable to third parties as part of such transaction (such as costs, expenses and taxes), where the money is essentially 'going in a circle'. In structuring any sale to a creditor, consideration must also be given to the duty on receivers and mortgagees when exercising a power of sale to take all reasonable care to sell the property for market value (or if the property does not have a market value, for the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold).

Credit bids are not particularly common in Australia, although they have increased in recent years due to greater numbers of distressed investment funds pursuing loan to own strategies in the Australian market.

22. Are there any rules regarding 'self-dealing' that restrict the ability to credit bid?

Under Australian law a mortgagee exercising its power of sale may not sell the property to itself. However, the scope of this rule is fairly narrow in practice, as it does not prevent a sale by the mortgagee to its subsidiary and does not apply to sales by receivers, administrators or liquidators.

Pre-packaged sales/reorganisations

23. Are pre-pack sales or reorganisations permitted or usual?

Pre-packaged insolvency sales (as practised in United Kingdom) are unusual in the Australian market for a number of reasons, including:

- that receivers (and mortgagees) are subject to a statutory duty to take all reasonable care to sell the property for 'market value' (or if the property does not have a market value, for the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold). This has been interpreted by the courts as requiring a focus on the process followed by the receiver to value and market the property (rather than the price obtained);
- administrators and liquidators are subject to duties of independence, which can prevent them from having a 'substantial prior involvement' with companies prior to their appointment;
- the relative stringency of Australia's insolvent trading laws; and
- a general reluctance by administrators to effect sales without creditor approval (whether under a DOCA or otherwise) at a creditors' meeting, or with court approval.

> Pre-packaged sales or reorganisations are rare.

24. Is it possible for creditors and the company to pre-agree a restructuring prior to commencing a formal reorganisation process?

It is possible (and the normal practice) for a majority of the relevant group of creditors and the company to pre-agree for a restructuring to be effected by way of a scheme of arrangement. Typically this would be done through agreeing a restructuring or lock-up agreement that binds creditors to vote in favour of a scheme of arrangement, the terms of which are appended either in summary or long form. Ideally such an agreement would be signed by 75% (or more) in value and a majority in number of the relevant creditors (to ensure the scheme is passed). In practice it may be difficult to secure the majority in number of creditors if there are a large number of small holders.

There can also be a degree of pre-planning involved in formulating the DOCA to be proposed by a director or creditor in an administration. Typically however, this is less formal than the practice involved with schemes of arrangement, in part because it is not possible to propose or approve a DOCA at the outset of an administration; instead this must wait for the second meeting of creditors (refer to "Stages and timing" under Question 1 above in relation to the timing of that meeting). This is also complicated by the factors referred to above in respect of pre-packaged sales.

Debt trading

25. Is it common for the debt of distressed companies to be traded?

Yes. It is common for corporate loans, bonds and other debt claims to be traded in Australia where a company is distressed, and there is an active secondary debt market.

26. Are there any legal or process restrictions on who can acquire the debt of corporate borrowers?

There are few legal restrictions on acquiring corporate loans, bonds or other debt claims in Australia (although there may be restrictions under the terms of the finance documents themselves).

Depending on the nature of the instrument, withholding tax may be payable on interest payments to offshore lenders/ transferees. Generally the withholding rate is 10%, unless reduced under an applicable tax treaty.

A loan or debt claim may be an ‘account’ for the purposes of the PPSA. If so, a transfer of the loan or debt claim is treated as a security interest even where it is an absolute transfer (and not a transfer made by way of security), and in that case the transferee should register against the transferor on the PPSR. In some circumstances a failure to register can result in a loss of priority rights to the transferred loan or debt claim.

In some cases, a transferee that acquires a loan or debt claim must register with APRA under the *Financial Sector (Collection of Data) Act 2001* (Cth). The transferee is obliged to register even if it is not carrying on business in Australia. The requirement to register applies, for example, if more than 50% of its assets in Australia are 'financial assets' (as defined therein) and its total assets in Australia exceed A$5 million. When its assets exceed A$50 million the transferee must lodge periodic reports with APRA.

A transferee that carries on business in Australia (or which is a subsidiary of an entity that carries on business in Australia) may provide a designated service (for example, advancing further loans) for the purposes of the *Anti-Money Laundering and Counter Terrorism Financing Act 2006* (Cth). This may require enrolment with the Australian Transaction Reports and Analysis Centre.

Foreign investment laws may also apply, depending on the circumstances of the case, although a broad exemption for money lending covers most cases.

Debt for equity swaps

27. What process is required for a debt for equity swap outside a formal reorganisation procedure?

Share issuance by unlisted companies

Any issue of shares by an unlisted company (whether a public or a proprietary company) must comply with the Corporations Act, as well as with any applicable provisions in the company's constitution and in any shareholders' agreement.

The Corporations Act contains a provision (which can be replaced in a company's constitution) to the effect that any share issuances for proprietary companies must first be offered to existing shareholders on a *pro rata* basis. There is no equivalent provision in the Corporations Act for unlisted (or listed) public companies.

Subject to the terms of a company's constitution and any shareholders' agreement, the power to issue shares resides in the board of directors. The nature of the board and/or shareholder resolutions that are required to issue shares will depend on the terms of the company's constitution and any shareholders' agreement.

Share issuance by listed companies

Listed companies must be public companies; a proprietary company cannot be listed. Subject to the terms of a company's constitution, the power to issue shares resides in the board of directors. However, shareholder approval may also be required to issue shares in certain circumstances, under either the Australian Securities Exchange Listing Rules ("**ASX Listing Rules**") or the Corporations Act (as applicable), including where:

- the shares would cause the company to exceed its 12 month 15% placement capacity under the ASX Listing Rules; or
- a recipient of the shares would (either alone or together with its associates) emerge with voting power in excess of 20% in the company ("**20% Rule**"), unless the issuance is occurring as part of a creditors' scheme.

28. To what extent can a debt for equity swap be implemented without such processes in a reorganisation procedure?

In any reorganisation, the terms of the company's constitution and any shareholders' agreement will need to be considered. Assuming the company's constitution and any shareholders' agreement do not contain any relevant restrictions on the issue of shares.

As noted above, the 20% Rule does not need to be complied with if the issuance occurs as part of a creditor's scheme.

Shares can be issued as part of a DOCA, without the need for shareholder approval, provided that (i) the company (assuming it is a listed company) would not, as a result of the issuance, exceed its 12 month 15% placement capacity; and (ii) no recipient of the shares would (either alone or together with its associates) emerge with voting power in excess of 20% in the company.

Already issued shares can be compulsorily transferred from existing shareholders to new shareholders under a DOCA, without the need for shareholder approval, provided that the court approves the transfer and no transferee of the shares would (either alone or together with its associates) emerge with voting power in excess of 20% in the company.

29. Are there any foreign ownership restrictions on companies or other assets?

Yes. Generally speaking, a 'foreign person' must obtain foreign investment approval before acquiring 20% or more in an Australian entity that is valued at A$261 million (this dollar figure is indexed annually) or more. Certain sectors have lower monetary thresholds (for example, agribusiness) or lower percentage thresholds (for example, media), and investors from certain treaty countries (for example, the United States of America) have the benefit of elevated monetary thresholds (A$1.134 billion). Foreign investment approval is also required in respect of the acquisition of Australian real estate (including interests in companies and trusts that have significant holdings of Australian land), subject to monetary thresholds that vary depending on the use of the land (for example, A$0 for residential land and A$261 million for developed commercial land).

In addition, foreign government investors (including certain pension funds, foreign government instrumentalities and corporations or trusts in which foreign governments have significant holdings) must obtain foreign investment approval before acquiring a 'direct interest' (generally, 10% or more) in an Australian entity or any interest in any Australian land.

Informal financial restructurings and work outs

30. Are informal financial restructurings of distressed companies common?

Informal financial restructurings are very common in Australia. Australia's insolvent trading laws (which traditionally required a company to maintain solvency during any attempt at a workout outside of external administration) often pose a challenge to achieving an informal restructuring. Therefore, informal financial restructurings in Australia often involve interim standstill or forbearance arrangements to provide directors with additional comfort with respect to solvency.

Cross border insolvency

31. Has the UNCITRAL Model Law been adopted? Are there any significant modifications to its application?

Yes. The UNCITRAL Model Law has been adopted in Australia pursuant to the *Cross-Border Insolvency Act 2008* (Cth). In the case of inconsistency between the Model Law and existing cross-border provisions in the Corporations Act, the Model Law is deemed to prevail.

There are no significant modifications to the Model Law. Some amendments have been made, which are confined to either adopting alternative wording (in relation to Article 13 of the Model Law), or imposing additional requirements to ensure notification of the court of any proceedings or relevant matters under Australian law (in relation to Articles 15 and 18 of the Model Law).

32. Have the courts adopted the JIN cross-border cooperation guidelines?

Yes, the JIN cross-border guidelines were adopted by the Supreme Court of New South Wales on 15 September 2017. Other Australian courts are currently considering adopting the guidelines.

33. Are there any other grounds upon which assistance or recognition can be granted to foreign insolvency processes?

Yes. Section 583 of the Corporations Act allows for foreign companies and unregistered companies that carry on business locally to be wound up by an Australian court, and section 601CL provides for ancillary liquidations of registered foreign companies.

Sections 580 and 581 of the Corporations Act allow for the issuing and receiving of letters of request for assistance in insolvency matters from courts in certain other countries. In the case of prescribed countries, courts are required to act in aid of and be auxiliary to the foreign courts, and in the case of other countries, courts have a discretion whether to provide assistance at all. The prescribed countries are the Bailiwick of Jersey, Canada, Papua New Guinea, Malaysia, New Zealand, Singapore, Switzerland, the United Kingdom and the United States of America.

In addition, assistance may be available at common law, although there is little Australian jurisprudence on this.

Recent trends and developments

34. Describe any recent trends or developments in Australia

- **The *ipso facto* law reform** took effect on 1 July 2018. It only applies to contracts entered into on or after that date. The regime restricts the termination of, or enforcement of other rights under, contracts based on an administration, receivership or scheme of arrangement proposal in respect of a company. Statutory regulations and a declaration set out the types of contracts and rights that are excluded from the ipso facto stay. The excluded types of contracts include (among others) syndicated loans, bonds, promissory notes, financial products, derivatives and certain securitisation, public-private partnerships and project finance arrangements involving special purpose vehicles. The excluded types of rights include (among others) certain rights to appoint receivers, termination rights in a standstill agreement, and rights of set-off and netting. There is some uncertainty as to the ambit and practical application of the reforms.
- **High profile group restructures:** There have been a number of high profile restructures where, in particular, parties are seeking to implement 'loan to own' strategies by way of a scheme or DOCA. Recent key restructures include:
  - the Emeco Holdings Ltd scheme, where US$280m senior secured 2019 notes were replaced with new senior secured 2022 notes for 80% of the notes and the remaining 20% was issued as equity;
  - the DOCA in respect of Ten Network Holdings Limited, where it was held that shares of no value (based on valuation evidence) could be divested for no consideration by a deed administrator pursuant to section 444GA of the Corporations Act;
  - Bis Industries, the ownership of which was transferred to its senior lenders via two schemes and a subsequent recapitalisation of the group's balance sheet through a partial debt for equity swap (senior lenders were advised by Herbert Smith Freehills);
  - Boart Longyear Limited, in which the Australian court controversially held that a term loan lender and secured

noteholders could be placed in the same class for scheme voting purposes, despite those creditors having different rights (and commercial interests) both before and after the scheme; and

  - Slater & Gordon, which involved a senior lenders scheme and a separate shareholder claimant scheme that was used to extinguish all shareholder claims against the company in exchange for the opportunity for such claimants to participate in a limited fund (the shareholder claims had to be extinguished in order to obtain senior lender consent to a debt for equity swap).

- **Environmental liability of liquidators in Queensland:** At first instance, the Queensland Supreme Court held that the liquidators of an insolvent company (Linc) are required to use available funds to cause the company to comply with its environmental obligations under an environmental protection order issued to Linc. This effectively gives such environmental claims priority over other creditors. However, the Court of Appeal subsequently overturned this decision, and held that liquidators, by disclaiming the land, also disclaimed the related obligations and liabilities as they could not be severed. It is unclear whether the decision will be further appealed to the High Court.

- **Creditor activity:** There have been trends of increasing levels of activity by offshore credit funds and distressed debt investors who are driving the larger restructuring deals. Banks are generally supporting distressed companies (or not taking enforcement action), or seeking to exit their positions - bank enforcement is rare. There is also continued growth in special situations lending, with alternative capital providers providing refinancing or recapitalisation solutions to distressed companies, and new money and working capital on restructuring exits.

- **Areas of distress:** In recent years there have been a significant number of restructurings and insolvencies in the mining, mining services and energy sectors, due to falling global commodity prices and significantly decreased activity in the mining sector. More recently there has been an increase in distress in the retail and construction sectors.

- **Insolvency Law Reform Act 2016 (Cth):** The new *Insolvency Law Reform Act 2016* (Cth) makes extensive changes to the Corporations Act regarding in particular, the regulation of insolvency practitioners and procedural matters in formal insolvency procedures.

- **Insolvent trading 'safe harbour':** The insolvent trading 'safe harbour' law reform was passed by parliament and received royal assent on 18 September 2017. See Question 17.

- On 5 March 2018, the *Financial Sector Legislation Amendment (Crisis Resolution Powers and Other Measures) Act 2018* (Cth) commenced. It gives APRA clear, fast-moving powers for crisis resolution and resolution planning to take control of, or appoint an administrator to, distressed banks, insurance and life insurance companies. APRA may also give directions in respect of recapitalisation and restructuring. The Act creates a regime that runs adjacent to the existing insolvency regimes.

Law reform

35. Is there any anticipated insolvency, restructuring or security law reform in Australia?

- In late 2017, the Australian Government announced that it would be proposing a number of actions to tackle illegal phoenixing including, among other things, a director identification number to make it easier to identify and prosecute individuals, specific phoenixing offences, extending the penalties for people that promote tax avoidance schemes, and identifying high risk individuals who will be subject to new prevention tools.

Glossary and abbreviations

20% Rule
where a recipient of the shares would (either alone or together with its associates) emerge with voting power in excess of 20% in the company

APRA
Australian Prudential Regulation Authority

ASIC
Australian Securities and Investments Commission

ASX Listing Rules
Australian Securities Exchange Listing Rules

Circulating security interest
a security interest over personal property (for example, accounts or inventory) where the secured party has consented to the grantor transferring the property in the ordinary course of the grantor's business

Corporations Act
Corporations Act 2001 (Cth)

Decision Period
the period being 13 business days from notice of appointment of the administrator within which the holder of security over all or substantially all of the assets of the company may take enforcement action

Deed of company arrangement or **DOCA**
a restructuring plan that can be proposed within the administration process (see Question 1 "Administration" – "Implementation of a reorganisation or restructuring 'plan'")

Perfection
under the PPSA, security interests in personal property must be perfected through registration on the PPSR, or control or possession by the secured party of that personal property

PPSA
Personal Property Securities Act 2009 (Cth)

PPSR
Personal Property Securities Register

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