Submission

Corporate Insolvency in Australia

TMA Australia Submissions

30 November 2022

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1 Introduction

1.1 Introduction

The Turnaround Management Association of Australia (TMA) welcomes the opportunity to provide submissions in response to the Parliamentary Joint Committee on Corporations and Financial Services inquiry into the effectiveness of Australia's corporate insolvency laws in protecting and maximising value for the benefit of all interested parties and the economy (the **Inquiry**).

1.2 About TMA

TMA is a non-profit association part of the global TMA network, comprised of a diverse community of professionals dedicated to turnaround and corporate renewal. Our membership includes restructuring advisors, lenders, investors, lawyers and other stakeholders in the turnaround industry and includes registered liquidators who work in turnaround. We believe our members and their firms play a significant role in many turnaround situations and provide a representative view of the turnaround industry. Given TMA members' exposure to most of the larger complex restructures taking place in Australia, TMA welcomes any opportunity to engage with the Government on these issues in more detail.

Our members share the common goal of stabilising and revitalising the business community. We are committed to the ongoing learning and development of Board members, and proprietors of distressed and underperforming companies. We advocate for early intervention before a company is at risk of insolvency to help preserve jobs, stimulate the economy and improve community engagement. Beyond this, we are committed to improving broader policy and reform measures which affect the business community in the pursuit of mitigating corporate losses and failures.

1.3 Outline of submissions

This document provides the Parliamentary Joint Committee with an overview of TMA members' views on key issues raised by the Inquiry. In light of the breadth of matters covered by the Terms of Reference, this submission is not comprehensive but rather puts forward key issues for further consideration by the Joint Committee. This document also compiles detailed submissions previously made by TMA in response to requests for submissions from Treasury and other Government initiatives.

Some of the terms of reference are outside TMA's objects, and we therefore comment only on those areas that affect turnaround and corporate renewal, with the exception of the issues we raise regarding gender equality in the profession.

1.4 Acknowledgement

TMA and the authors of these submissions acknowledge the assistance and feedback of the various TMA members who have contributed to the discussion of the issues surveyed and included in these submissions, as well as the other local and international professionals and academics who have kindly shared their time and insights with us. Any errors or omissions are attributable to the relevant authors.

1.5 Views expressed in these submissions

The views expressed in these submissions represent the views of its authors and do not necessarily reflect the views of all members of TMA. In preparing these submissions,

the authors have sought and considered the views of a representative sample of TMA members and sought to reflect a considered position that, on the key questions, best reflect the majority views of the broader TMA membership.

However, as can be expected for a “broad church” such as TMA, contrary views have been expressed to us on a number of the points made herein. We have endeavoured to note the key places where this is the case.

1.6 Intellectual property

The contents of these submissions remain the intellectual property of the relevant authors and/or TMA as applicable. These submissions may be reproduced but should not be used or reproduced without attribution to TMA.

1.7 Disclaimer

The contents of these submissions are for reference purposes only and may not be current as at the date of these submissions. The submissions provide a summary only of the subject matter covered, without the assumption of a duty of care by TMA, its members or any of the contributing authors. The submissions do not constitute legal advice and should not be relied upon as such.

2 Executive Summary

In providing our submissions, we have sought to balance our object, to promote corporate turnaround and renewal, against efficient and effective regulation. Whilst there are a number of issues raised, and we draw heavily from previous submissions made by TMA, there are 5 major points, we would like to particularly emphasise.

2.1 Gender balance needs to be addressed

TMA as an industry body is committed to gender equality, and the underrepresentation of women in insolvency is an issue of concern which is consistently raised by our members.

The broader insolvency industry suffers from a significant and continuing gender imbalance, with women making up only 9% of registered liquidators. While turnaround and restructuring practitioners do not overlap completely with registered liquidators, many of the leaders in the space are registered liquidators and have a formal insolvency background.

An obvious area that should be considered for reform relates to the way in which registered liquidators are qualified, which currently discourages women from becoming registered liquidators. Specifically, there is a need to demonstrate 4000-hours of experience within 5 years prior to an application to become a registered liquidator. This is problematic for aspiring registered liquidators who have (or anticipate that they may have) parental leave or caring duties that impact their ability to meet that requirement. As has been reported to us, you may be able to meet the 4000-hours requirement if you have one child in the 5-year period, but it is almost impossible if you have 2 or more children in that period.

There is no provision to pro rata extend the 5-year period to allow for periods of parental leave (or indeed other significant leave) taken within the 5 years prior to an application, or to reflect part time working arrangements.

While we understand that ad hoc discretion has been applied by the regulator where the 4000-hours in 5 years requirement has not strictly been met by working mothers, this is not adequate, especially as the basis on which the discretion will be exercised is not publicised. Becoming a registered liquidator is onerous, and women embarking on that long road ought to know how the requirements will be applied to them (and that they will be applied fairly) if they have periods of parental leave.

Further, the 4000-hours in 5 years requirement should be more broadly reviewed: it biases quantity over quality. Whilst there is an oral exam in Australia, other jurisdictions have been able to allow a broader range of practitioners to enter the profession without the need for such extensive hours, but with a more significant examination. For example, in the United Kingdom (**UK**), there is only a 600-hours requirement within a 3-year timeframe, but successful applicants need to pass a thorough exam to be registered.

Similarly, the strict requirement that registered liquidators undertake 120 hours of continuing professional education every 3 years (see rule 20-5 of the Insolvency Practice Rules (Corporations)) does not allow for periods of parental or other significant leave or part time work. Other industry regulators (such as the Law Society of New South Wales) adjust these requirements to allow for part time work or significant leave. Similar appropriate flexibility should be allowed for registered liquidators.

2.2 Holistic review should be undertaken

The insolvency law has not been subject to a full review since the Harmer review was conducted in 1988. We have previously raised with the Government that there are significant advantages to the Government in undertaking a holistic and thorough review of Australia's restructuring and insolvency framework by a suitably qualified and diverse panel of experts, with appropriate time and breadth taken to consider views through the use of position papers, hearings and fuller submissions.

Amongst other matters experts might consider the relative merits of:

- a thorough review of the administration and deed of company arrangement (**DOCA**) regime, including with reference to the issues we discuss in these submissions;
- an introduction of a more developed priority funding regime for Australian insolvency processes (sometimes misdescribed as 'debtor in possession" funding) and providing incentives and/or removing barriers to funding/investing in distressed businesses, including;
  - Providing tax breaks for the provision of equity or debt for investors in distressed situations
  - Accelerating capital raisings by allowing for "low-doc" raisings
  - Clearer valuation principles around debt for equity swaps
  - Clearer tax loss rules in DOCAs
  - Clarifying the tax rules around change of control transactions
  - Reducing transaction taxes in distressed situations
- a review of the *Personal Property Securities Act 2009* (Cth) (**PPSA**) rules to ensure efficiency;
- the Safe Harbour rules, including taking on the recommendations of the recent review of the regime;
- cross class cramdown rules for creditor schemes of arrangement (similar to those introduced in the UK as part of the new restructuring plan procedure);
- pre-packaged sales in an administration in appropriate circumstances (having regard to the various issues discussed in our submissions) and pre-packaged creditors' schemes of arrangement (similar to that introduced in Singapore); and
- consideration and clarification of the conflict rules applying to insolvency practitioners who have been involved in advising the company prior to a formal insolvency appointment.

These are matters requiring regulatory and judicial overview.

2.3 Lack of quality data

ASIC provides some statistical data, but it is relatively high level and relates more to the number of appointments of insolvency practitioners in each type of formal appointment. In terms of significant changes to the insolvency regime and to the extent possible, data should be used to identify the extent of issues in the industry. Areas that might require further research include the extent of phoenixing activity, a comparison of outcomes across formal and informal restructurings, and remuneration, to name a few.

2.4 Promotion of turnaround

Entrepreneurial risk taking is a necessary element of business innovation that supports a vibrant and strong economy. However, some businesses get into distress as a result of this risk, and some may ultimately fail.

We at TMA believe that if a business can be saved, it should and this should be prioritised over allocating blame for the failure. This does not mean that corporate malfeasance should be ignored, but that the emphasis should be on corporate rescue first, malfeasance second.

TMA was set up to encourage a turnaround culture in Australia, which has been seen globally as a more creditor-friendly regime in the past.

This meant that in distressed situations, creditors rights are paramount, even if that resulted in the business being wound up. This comes at a significant cost to business and the community and has often resulted in prolonged and expensive litigation.

Australia's restructuring culture is slowly changing to a more balanced approach where the numerous stakeholders, including customers, suppliers, employees and even community and Government interests, are being considered more holistically.

TMA would like to play its part in developing this more balanced approach, including through education and promotion of corporate turnaround. Any Government support for those aims, such as a director outreach program and education programs, would be supported by TMA.

In addition to the above, TMA is a strong proponent for early intervention and ensuring directors have access to the right resources early in the distress cycle of a company.

As discussed later in these submissions, it is important for directors to understand when is the right time to engage with turnaround resources and professionals.

2.5 Previous submissions

TMA have previously made submissions TMA to the Government in relation to a number of proposed law reforms aimed at improving the operation and effectiveness of the existing laws in relation to corporate restructuring and the broader Australian insolvency and restructuring law framework. A number of these submissions were not taken on board, but remain valid and worthy of consideration for reform. Specifically, our previous submissions on Safe Harbour, Schemes of Arrangements, and the Simplified Business Restructuring Reforms, are worth considering further.

3 TMA's approach to Consultation Paper

3.1 Approach to insolvency and restructuring law reform

TMA considers that there are significant advantages to the Government undertaking a holistic and thorough review of Australia's restructuring and insolvency framework. A holistic review has not occurred since 1988 and should be prioritised over piecemeal reform.

We believe that such a review should be undertaken by an appropriate body of qualified and experienced experts in the field of restructuring, turnaround and insolvency. Such a body should include members across Australia, with not only legal, but also academic, economic, financial and business backgrounds. The body should be provided the time and resources to undertake a proper review, which might occur in stages and would likely involve issuing interim papers, receiving submissions and holding hearings and other sessions to elicit discussion, feedback and perspectives from a broad range of stakeholders. A review of this nature will necessarily be engaged in consideration of points of policy, and therefore should not be dominated by the views of any particular constituency.

There are numerous issues to be considered in respect of Australia's current corporate insolvency laws – far too many to be addressed in a consultation paper of this type and the limited time allowed. The issues range from matters of broad policy and approach, effectiveness of the existing regimes in meeting policy objectives, advances in restructuring and insolvency practice (and business practices) since the last major legal review, international developments, coordination and thinking, practical problems with the operation of the existing law, impact of the existing regime on various different stakeholders and business types, technical errors and fixes, consistency and clarity and simplification.

This submission aims to highlight a small number of the areas which ought to be further considered as part of any holistic reform, or alternatively, if the Joint Committee does not intend to conduct such a holistic review, separately from that process. These issues largely arise from work previously undertaken by TMA and its members in respect of previous consultations. Our submissions set out below therefore largely cross refer to those previous TMA submissions and reports which we have appended for ease of reference.

Given the breadth of matters covered by the consultation, the limited period given to the public to respond, and other time commitments of those involved in preparing this response, it has not been practical to undertake a more comprehensive survey of the issues relevant to the terms of reference or undertake any new substantive work in response to these queries.

We provide our comments in the context of the aims of TMA, which is to promote turnaround and corporate renewal and how the insolvency laws could be adjusted to promote these aims, which is of benefit to the wider economy.

3.2 Lack of data

The insolvency industry suffers from a lack of reliable data in relation to levels of insolvency and outcomes. This means that changes to the legislative regime are generally not supported by empirical evidence, but rather by anecdotal evidence. Much of

the data is based on the somewhat subjective experiences of those practising or otherwise involved in the field (and who choose to share their views via articles, survey participation or submissions in response to consultation processes such as this). One of our member firms, KordaMentha, conducts a survey into topical issues in turnaround each year. The most recent survey is attached as ***Appendix 1***.

There are a number of areas that could be better understood if data were more readily available, and TMA would support a move to fund further research into insolvency and restructuring in Australia.

As noted above, there is , unfortunately, relatively little data on the operation or effectiveness of Australia's corporate insolvency laws beyond the high-level statistics on the number of appointments of insolvency practitioners published by ASIC. This is a significant challenge when seeking to undertake serious study or consider policy options in respect of the current legislative framework. Without sufficient evidence, there is a risk that any recommendations are not effective, or at worst, detrimental to the desired outcomes.

4 Submissions

TMA makes observations and recommendations in response to the matters raised by the Terms of Reference (**TOR**) in section 5 to section 11.

5 TOR 1 - Effectiveness of Australia's corporate insolvency laws in protecting and maximising value for the benefit of all interested parties and the economy

Because of the lack of data (as discussed above), we have drawn on the outcomes of the KordaMentha TMA Australia 2022 Turnaround Survey (the **Survey**) released in November 2022. In addition, we also include some of our member's observations.

The Survey drew responses from 114 respondents across a range of lenders, lawyers, corporate advisors, investors, insolvency professionals, service providers, board members, management and other respondents.

The key findings of the Survey were:

1. 61% of respondents expect a recession within the next 24 months;
2. 70% of respondents believe insolvency appointments will return to pre-COVID levels within the next 12 months;
3. 63% of respondents believe rising input costs and workforce are the biggest pressures on business. Supply chain delays were continuing to be reported as an issue for 53% of respondents;
4. 59% of respondents believe cost reduction initiatives will be highly important for their clients in the coming year; and
5. 88% of respondents believe the most common response by lenders and owners will be to explore options outside of formal insolvency appointments.

These findings, alongside insights gained from consultation with various members of TMA, have shaped the below commentary. The Survey is attached as ***Appendix 1***.

5.1 TOR 1(a) - Temporary COVID-19 Pandemic Insolvency Measures

The temporary insolvency measures which included an exclusion of liability for insolvent trading and changes to the thresholds and timing for statutory demands and bankruptcy notices were effective in slowing the rate of insolvency during the COVID-19 pandemic. Whilst the Government's temporary relief measures might arguably have interfered with the natural and unavoidable process of "creative destruction", they also presented a unique opportunity for businesses to take stock and, with appropriate support, effect a successful restructure.

5.2 TOR 1(b) - Recent Changes in Domestic and International Economic Conditions

The Survey indicated that rapidly rising inflation and interest rates in addition to rising input costs have led to economic strain on many Australian businesses. Consequently, we have seen the number of insolvencies rise from the low rates observed during the COVID-19 pandemic, although they remain below pre-COVID levels (which were artificially low due to the Temporary COVID-19 measures mentioned above). Both the Survey and our canvassing of TMA members indicate that there is a strong view that there will be an increase in insolvency appointments and financial pressure on businesses over the next 12 months.

Anecdotally, our experience is that there has been a rise of non-bank finance in Australia over the last 5 years, particularly for riskier lending and higher leverage loans. Australian banks have retreated from lending in a number of riskier sectors or have sought to reduce exposures. Accordingly, recent corporate restructurings and insolvencies in the Australian market have increasingly involved private credit funds and direct lending arrangements rather than traditional bank lenders. We expect this trend to continue. Conversely, there has been relatively little secondary trading of distressed loans in the Australian market in recent years.

5.3 TOR 1(c) - Other Contributing Factors to Insolvency Patterns

TMA is of the view that increased awareness of the Safe Harbour regime has led to an increase in the use of Safe Harbour by distressed company boards. However, as companies entering Safe Harbour are not required to report to any authority that they are in Safe Harbour, we do not have sufficient empirical evidence to support this. In ***Appendix 2***, TMA included 55 short case studies provided by our members that demonstrated that the take up of Safe Harbour is significant.

TMA is strongly of the view that where Safe Harbour has been deployed appropriately, it provides companies more time to restructure, which in turn gives them a higher likelihood of recovering from distress. Again anecdotally, this is likely a factor in significantly reduced administrations, particularly in larger and more complex matters.

Our members have also observed an increasing number of financial institutions opting to enter into discussions with distressed customers in the hope of negotiating a repayment plan or reaching an alternative solution, rather than enforcing their security to recover debt. The decline in receivership appointments is a continuing trend from prior to COVID-19 and is likely more due to criticism of various financial institutions as a result of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry prior to the commencement of the COVID-19 pandemic. We refer to ***Appendix 3 ASIC Receivership Statistics***.

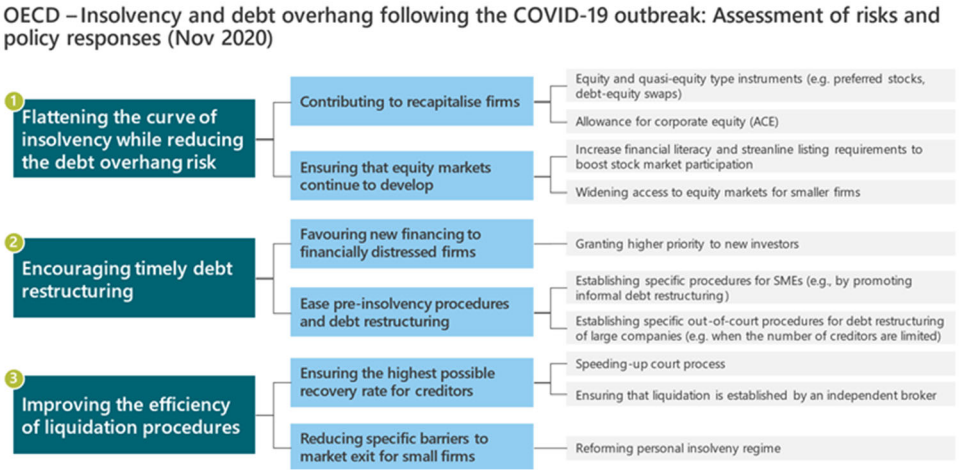
5.4 TOR 1(d) - International Responses to Surviving Business Reforms

According to a World Bank analysis, small businesses represent 95% of all enterprises and account for more than 60% of employment worldwide. Micro and small enterprises (**MSEs**) are often led by entrepreneurs backed by their own funds. The principals of most are time poor and, generally, are relatively unsophisticated users of advisory support. Many MSEs address liquidity needs by stretching creditors, deferring payment of employees and/or missing tax, regulatory and local government payments.

As a result, MSEs often avoid addressing problems in the business until late in the business survival cycle. This can lead to the loss of support of suppliers, employees, banks and other parties usually of importance in helping a business survive a liquidity crisis.

There is an emerging consensus between World Bank, UNCITRAL and OECD agencies of a need to develop adaptive insolvency and pre-insolvency systems to assist MSEs (domestic insolvency systems are mostly appropriate for large corporates). TMA encourages the Inquiry to read the papers referred to below for a non-exhaustive list of useful references.

OECD has published a useful decision map regarding reforms assisting businesses in recovering from COVID conditions, these matters having equal application in assisting business resolve liquidity pressures



TMAA refer the Inquiry to these international references:

- Principles for Effective Insolvency and Creditor and Debtor Regimes, World Bank Group - https://documents.worldbank.org/en/publication/documents-reports/documentdetail/391341619072648570/principles-for-effective-insolvency-and-creditor-and-debtor-regimes
- Solvency Entrepreneurs, Saving Enterprises: Proposals in the treatment of MSME Insolvency, World Bank 2018/09/17 - https://documents.worldbank.org/en/publication/documents-reports/documentdetail/989581537265261393/saving-entrepreneurs-saving-enterprises-proposals-on-the-treatment-of-msme-insolvency
- https://blogs.worldbank.org/psd/new-principles-insolvency-supporting-small-businesses-key-role-covid-19-recovery

- OECD: Insolvency and debt overlay: Assessment of risks and policy responses (Nov 2020)

6 TOR 2: Operation of the existing legislation, common law, and regulatory arrangements

6.1 TOR 2(a) – the Small Business Restructuring Reforms (SBRRs)

TMA made detailed submissions in respect of SBRRs of 2021. Unfortunately, many of TMA's submissions were not reflected in the SBRR legislation that was enacted. Based on ASIC data published to date, the Small Business Restructuring Process has only been used 100 times this financial year to date (compared to 436 administrations and 1576 liquidations in the same period in 2021). This low take up suggests the regime is not working effectively to date. We consider that there needs to be some consideration by the Government of the small business restructuring laws which were enacted, including whether the Government might adopt more of TMA's recommendations which could lead to the regime being more broadly adopted, understood and used more effectively.

A few of the key points we made in those submissions included that:

- the scheme needed to be simple and there should be a pro forma restructuring plan made available that could easily be used by companies and their advisors for most cases;
- there should be a higher monetary cap on liabilities for eligibility;
- the regime needs to address the personal guarantee liabilities (and potentially mortgages) typically granted by directors/owners of small businesses; and
- there should be a targeted program for the education of small business owners about the reforms.

TMA also made a significant number of submissions about the technical operation and clarity of the regime, its consistency with other provisions and safeguards. The failure to implement these suggestions has not had a significant impact in practice to date given the low usage of this regime. However, we note that these recommendations will become important if the regime becomes more broadly used, and therefore it is important that these recommendations are also considered to reduce complexity and cost.

One significant issue raised by TMA members was the need for some consideration to be given to the liability of a restructuring advisor under the regime, which is currently unclear. With limited fees and uncertain risks/downsides, many restructuring advisors may be choosing not to provide these services, even when a company meets the threshold requirements.

TMA's previous submission is attached at ***Appendix 6 – Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 Exposure Draft***.

6.2 TOR 2(b) – the simplified liquidation reforms

TMA does not have a view on these reforms.

6.3 TOR 2(c) – the unlawful phoenixing reforms

There are mixed views on the unlawful phoenixing reforms among TMA members. There is, at this stage, little in the way of hard data to evaluate the effect of these measures - to date there is only one reported instance of their use.[1]

We note that the illegal phoenixing reforms have two key aspects:

- duties/obligations on officers and others not to engage in or procure creditor defeating dispositions (sections 588GAB and 588GAC of the *Corporations Act 2001* (Cth) (**Corporations Act**) and related provisions); and
- the ability for the court or ASIC to set aside creditor defeating dispositions as voidable transactions (section 588FE(6) of the Corporations Act and related provisions).

The Safe Harbour provision (section 588GA) operates to protect officers or others from breach of the conduct obligations under sections 588GAB and 588GAC where the requirements of section 588GA are satisfied. However, the Safe Harbour provision does not provide any protection for third parties in respect of the transaction subsequently being set aside as a voidable transaction under section 588FE(6).

Some members take the view that the illegal phoenixing provisions are a useful deterrent to illegal phoenixing in Australia. They further consider that the Safe Harbour provision enables transactions to occur without breach of the misconduct provisions during a restructure and/or transaction where the Safe Harbour provisions are being complied with. Such members consider the early anecdotal indications of the impact of these reforms to be encouraging.

Other members are more sceptical of these reforms, noting that application of the Safe Harbour does not insulate the transaction from challenge as a voidable transaction (as noted above), and worry about the further complexity and risk to legitimate transactions. They also note that prior to their enactment, there were already voidable transaction-type provisions dealing with uncommercial transactions or transactions intended to defraud creditors. In this context such members question whether it was necessary to create a further broader category of voidable transactions.

Such members have noted the risk that measures of this type may be a substitute for properly funding the relevant bodies (or liquidators) to monitor, investigate, and where appropriate, take civil or criminal proceedings in respect of corporate misconduct or voidable transactions. This concern is particularly acute in the case of section 588FGAA which gives ASIC quasi-judicial powers to make an order setting aside transactions (instead of the normal process requiring a court order under section 588FF).

Given these mixed views, TMA considers that the role, appropriateness and effectiveness of these provisions should be revisited with the benefit of further data and in light of the principles and policy of the broader corporate insolvency regime. A reconsideration of the appropriate approach to the regulation and prevention of corporate misconduct and undervalue transactions would be beneficial.

[1] *Intellicomms Pty Ltd (in liquidation)* [2022] VSC 228

6.4 TOR 2(d) – the operation of the PPSA in the context of corporate insolvency

The PPSA regime has been operative for over 10 years and has served to remove many of the ambiguities in relation to personal property security interests that existed under the previous law.

However, views on the PPSA across the industry continue to be mixed, with complaints about the usefulness/accuracy of registrations and the extent of out-of-date registrations that must be investigated, understood and resolved during a restructuring or insolvency process.

The recommendations in the Whittaker Report

We note that the Final Report for the Statutory Review into the PPSA was conducted and written by Bruce Whittaker and tabled in the Australia Parliament on 18 March 2015 (the Whittaker Report). This detailed report considered a range of issues in respect of the PPSA and made a large number of recommendations. We understand the majority of these recommendations have not yet been addressed by the Government.

TMA recommends that the Whittaker Report recommendations should be examined as part of any law reform process. We have not appended this report due to its size.

Section 588FL of the Corporations Act

One issue of particular focus in the insolvency context is the operation of section 588FL of the Corporations Act. Whilst this is a section of the Corporations Act rather than the PPSA, it was introduced (in its current form) as part of the PPS law reforms and deals with certain circumstances in which such personal property security interests will "vest" (become void) where a company has entered a formal insolvency process.

Section 588FL provides that where a company goes into a formal insolvency process, a security interest will vest if:

- at the "critical time" (being, in essence, the time and day that the winding up or administration is taken to have commenced under the Corporations Act, whichever is earlier), or, if the security interest arises after the critical time, when the security interest arises:
  - the security interest is enforceable against third parties under the laws of Australia; and
  - the security interest is perfected by registration, and by no other means; and
- the "registration time" (i.e., the time the relevant financing statement registration is made on the register) for the collateral is after the latest of the following times:
  - 6 months before the critical time;
  - the time that is the end of 20 business days after the security agreement that gave rise to the security interest came into force, or the time that is the critical time, whichever is the earlier;
  - [*special rules for foreign security*]; and
  - a later time is ordered by the court under section 588FM.

The Whittaker Report recommended that section 588FL be repealed in its entirety (see [9.2.2] of the Whittaker Report). This was because:

- the need for the provision (which was a successor to a previous provision in the Corporations Act) had been overtaken by section 267 of the PPSA (which vests security interests that are unperfected upon commencement of formal insolvency), and there is a 'doubling up" in function between section 588FL of the Corporations Act and section 267 of the PPSA;
- it is not reflective of the unifying approach to personal property securities that otherwise applies under the PPSA, in that section 588FL only applies to certain types of grantors (being companies);
- the requirement to register security interests within 20 business days can create timing problems, for example where the grantor does not acquire the collateral until sometime later (and for example serial number details are required) or if the security interest arises under a lease that only becomes a security interest after expiry of the one-year period;
- the provision is not necessary to incentivise prompt registration as a secured party should be incentivised by the desire to set its priority position, to reduce the risk that a buyer or lessee take the collateral free of the security interest and to remove the risk of vesting under section 267; and
- late registration is likely to arise out of inadvertence, so the imposition of a further deadline will not result in the registration being made earlier.

TMA agrees with the recommendations contained in the Whittaker Report and notes that section 588FL has resulted in a significant number of court applications for extensions of time to file financing statements under section 588FM due to inadvertence. This appears to have achieved little benefit, and in fact the provision actually adds complication to the PPSA regime.

In addition, TMA notes that section 588FL has created an additional issue where administrators of a company seek to obtain funding secured by new personal property security granted by the company after the date of the administration.

A line of cases including *K J Renfrey Nominees Pty Ltd (atf Renfrey Family Trustee) v OneSteel Manufacturing Pty Ltd (subject to deed of company arrangement)* [2017] FCA 325 have held or assumed that section 588FL applies to security interests granted after the "critical time", and accordingly that such security interests would automatically vest on creation (on the assumption that there is no pre-existing financing statement registration). This has resulted in the practice of administrations and funders making court applications seeking extensions under section 588FM to allow time for the financing statements to be registered under section 588FL so as to ensure that the security granted during the administration would be validly perfected and not vest.

However, in the recent case of *Antqip Hire Pty Ltd (in liq)* [2021] NSWSC 1122 Brereton JA suggested that this previous understanding was incorrect and that section 588FL was only intended to apply to security interests granted before the critical time, and not to security interests granted after the critical time. The reference to a security interest "arising" (which may occur after the critical date due to, for example, the security interest attaching to collateral after that date) should be contrasted with the concept of entry into the security agreement which involves the grant of the security interest. Brereton JA therefore considered that section 588FL did not operate to vest security granted post administration and it was unnecessary to make an order for the extension of time under section 588FM.

Accordingly, TMA recommends that section 588FL is repealed in line with the recommendation in the Whittaker Report. To the extent that this recommendation is not

adopted by the Government, TMA suggests that section 588FL is amended to make clear that Brereton JA's interpretation of section 588FL is correct, to avoid the need for further cautionary section 588FM applications to be made by administrators at cost.

Circulating assets – sections 340 - 341A of the PPSA

In addition, we note that the Whittaker Report addressed the concept of "circulating assets" contained in sections 340 – 341A of the PPSA. This statutory concept was designed to roughly replicate the concept of a floating charge under pre-PPSA law. Whilst the PPSA abolished the distinction between a fixed and floating charge for most purposes, this concept was retained for certain purposes relating to corporate insolvency – namely that:

- under section 588FJ of the Corporations Act, a circulating security interest created within 6 months prior to the "relation-back date" (or after that date but before the winding up began) the security interest is void against the liquidator except as set out therein; and
- employees, and in some circumstances administrators, have a statutory priority to be paid from the proceeds of circulating assets ahead of the secured creditor (under sections 443D and 561 of the Corporations Act).

The concept of a circulating asset (including whether the secured party has control of the asset such that it is not a circulating asset) gives rise to significant complexity, and determining which assets are or are not "circulating assets" can require significant legal and factual analysis for administrators and liquidators. Further, these provisions lead to additional complexity in the drafting of finance and security documentation whereby secured creditors seek to take "control" of collateral such that it does not amount to a circulating asset.

The Whittaker Report recommended amending sections 340 to 341A of the PPSA so that collateral is only a "circulating asset" of a grantor if it is inventory (in the ordinary meaning) of the grantor (other than inventory subject to a PMSI), or its proceeds. The Whittaker Report also recommended moving these provisions to the Corporations Act (given they have no consequences for the operation of the PPSA, but only relate to the operation of the Corporations Act).

TMA recommends that consideration be given to adoption of the recommendations in the Whittaker Report in respect of circulating assets, or otherwise seeking to streamline this concept. In particular, TMA suggests that the policy intent behind the priority afforded to employees (and administrators) be reconsidered, and consideration be given to whether there is a more efficient manner to achieve those policy goals.

7 TOR 3: Other potential areas for reform

7.1 TOR 3(a) - Unfair Preference Claims

TMA does not currently have a definitive view on unfair preference reform. TMA notes that there are various policy considerations for the Government that need to be weighed, including considering overseas models, as part of any broader holistic insolvency reform.

In Australia, unfair preference laws are designed ostensibly to prevent a creditor from jumping to the front of the queue in relation to general unsecured creditors to the prejudice of the other creditors, all of whom should be paid equally and to ensure there is

no "*undignified scramble by creditors over available assets*" [2]. Section 588FA of the Corporations Act defines the preference as a transaction which results in a creditor receiving more in the winding up from the company in respect of the debt than if the transaction were set aside and the creditor had to prove for the debt.

Australia's unfair preference laws are one of a liquidator's most effective means of increasing the pool of assets available to be distributed to unsecured creditors in a winding up scenario and ensuring that such distribution is in accordance with the principle of *pari passu*.

In March 2022, the Morrison Government announced that it would further simplify and streamline insolvency laws so that viable businesses encountering economic challenges would have the opportunity to restructure their businesses to continue trading. It was proposed that creditors who act honestly and at arm's length should not be pursued for small payments where a company they dealt with enters liquidation. Further, it was proposed that transactions either amounting to less than $30,000 or are made more than 3 months prior to the company entering external administration, would no longer be able to be clawed back, provided those transactions involve unrelated creditors and are within the ordinary course of business.

The remaining elements of section 588FA which are required to be satisfied by a liquidator seeking to recover a payment made by the company as an unfair transaction, were not proposed to be amended, including where:

- there is a transaction between the company and a (unsecured) creditor of the company;
- the company was insolvent at the time of the payment; and

the creditor received more as a result of the transaction than it would have received in the liquidation of the company. In any holistic review of the insolvency laws, TMA recommends that the Government consider the laws relating to unfair preferences with a view to balancing the desire that there be an equal and fair distribution of the assets amongst the whole of the insolvent company's creditors.

The Government might consider the unfair preference laws enacted in the UK, Singapore and South Africa which have incorporated subjective (and more difficult) tests. These subjective tests require a liquidator to look at the intent or state of mind of the debtor company and establish that the debtor company which gave the preference was influenced by a desire or intent to improve the creditor's position when making the payment.

The Government might also consider the approach to unfair preference law as adopted in the United States (**US**). In contrast to the approach taken in the jurisdictions mentioned in the preceding paragraph, section 547 of the US Bankruptcy Code does not require an assessment of the intent or state of mind of the debtor company, but instead operates on an objective basis based on whether the transaction has preferential effect. However, section 547 provides an exception where the payment was:

- made in the ordinary course of business or financial affairs of the debtor and the recipient; or
- made according to ordinary business terms.

Section 547 of the US Bankruptcy Code also contains various exceptions where the recipient of the preference has provided "new value" (and on various other grounds). The

[2] James O'Donovan "Corporate Insolvency: Policies, Perspectives and Reform" (1990) 3 Commercial and Business Law Journal 1,11

preference period in the United States is only 90 days (except for transactions with "insiders" where the period is 1 year), but there is a presumption of insolvency during the 90 days prior to the commencement of bankruptcy.

There has also been much debate amongst commentators in relation to the running account principle encapsulated in section 588FA(3) of the Corporations Act which has not been judicially recognised in the UK as it has in Australia and New Zealand. This principle, although not a complete defence to an unfair preference claim by a liquidator under section 588FA, allows a party to rely upon an established ongoing business relationship which looks at the transactions' net position, rather than considering each individual transaction, when determining whether a creditor received a preference.

Until recently a liquidator could calculate the preference amount by capturing the highest point of debt owing to a creditor (the peak indebtedness rule) during the relation-back period as a shorthand way of calculating the net effect of the running account. However, the decision of *Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Limited (In Liq) (receivers and managers appointed)* [2021] FCAFC 64 (which is currently the subject of an appeal to the High Court of Australia) decided the peak indebtedness rule does not apply when calculating the value of a liquidator's unfair preference claim.

The other aspect which has been the subject of discussion is the mandatory right of set off in section 553C which allows the set off of mutual credits, mutual debits or other mutual dealings between a company and a person making a claim in the winding up of that company. This principle is also the subject of an appeal to the High Court from the decision of the Full Court of the Federal Court of Australia in *Gavin Morton as Liquidator of MJ Woodman Electrical Contractors Pty Ltd (In Liq) & Anor v Metal Manufacturers Pty Ltd* [2021] FCAFC 228 which confirmed that the defence of a statutory set off under section 553C(1) of the Corporations Act is not available against a liquidator's claim for the recovery of an unfair preference under section 588FA.

Therefore, TMA considers that a broader review of the overall unfair preference regime might be appropriate as part of a more holistic review of Australian restructuring and insolvency law.

7.2 TOR 3(b) - Trusts with corporate trustees

We understand broadly that there are several issues in relation to the recovery of assets held in trust structures for liquidators, and it can be costly (and at times, uneconomic) to pursue these assets for the benefit of creditors. However, specific commentary on these matters is outside the scope of TMA, so we only make limited comments below.

We do, however, consider that any proposal to enact a specific insolvency regime for trusts should be scrutinised carefully. We note that trusts are not a legal entity and therefore do not themselves incur debts or become insolvent.

The Harmer Report contained relatively simple proposals to amend the Corporations Act to make clear that a liquidator of a corporate trustee could continue to manage the business and affairs of which the company in liquidation is a trustee, and that any trustee "ejection" clause (which brings about the vacation of the office of the trustee) would be invalid and of no effect. This would remove the current practice of liquidators needing to apply to court to be appointed as receivers of the trust property where the trust deed provides for the corporate trustee to be terminated as trustee upon formal insolvency. TMA understands that these proposals have wide support but have not yet been enacted, and accordingly, TMA recommends consideration of adoption of those reforms.

7.3 TOR 3(c) - Insolvent trading safe harbours

The Safe Harbour amendments to the insolvent trading laws were, in TMA's opinion, a significant step forward in developing a turnaround culture in Australia. TMA has made submissions in response to the recent Insolvent Trading Safe Harbour review in October 2021. Paraphrasing those submissions, our conclusions were:

- Safe Harbour is effective in providing time and space for directors to plan successful turnaround, restructuring and workout strategies;
- Safe Harbour processes can run for a short period, though they typically extend over many months;
- the majority of Safe Harbour cases result in informal rather than formal processes. The most common formal process to be utilised as part of a Safe Harbour process is voluntary administration, sometimes supported by receivership;
- some advisors were (in our view wrongly) narrowly construing the pre-requisites for entry into Safe Harbour. Some boards appear to be taking the view (albeit we think incorrectly), that Safe Harbour is a disclosable event (either under listing rules or under financing covenants);
- companies were generally signing off on Safe Harbour as a "whole of business" strategy rather than, for example, as a “tick a box” or “checklist" approach as was feared;
- while the risk of director liability in a failing company is a powerful incentive in the minds of professional boards, directors without “skin in the game” were concerned about whether to expose themselves to risk by trading on distressed enterprises. Whilst boards do not necessarily immediately appoint voluntary administrators when in a crisis, robust and confident action becomes difficult to justify in the face of fiduciary risk;
- a more common problem is the one facing the investor nominee director; because of the structure of funds, the general partner managing the fund cannot expose itself to litigation risk when investing into a distressed situation. This appeared to be exacerbated by uncertainties and insolvency carve outs within director and officer insurance policies.

At the time of our submission in October 2021, there was significant liquidity in the market. We pointed out that this liquidity would likely not endure indefinitely, so some of the better outcomes achieved outside a formal process would probably require statutory moratorium (e.g., via voluntary administration) support in the future.

In summary, TMA felt that Safe Harbour did not abrogate the role of voluntary administration; it provided the time needed by directors to plan a turnaround strategy which may be executed inside or outside a formal process. Whilst the situation of each company will differ, we considered that the degree of liquidity in the market and support of a company's creditors are often likely to be key factors in determining whether a company’s plan could be implemented informally or whether the protection of a statutory moratorium may be required.

Our conclusion then, and our view still is, that Safe Harbour is largely working well to preserve value and assist businesses to restructure and survive.

Refer ***Appendix 2.1 – TMA Submission to Insolvent Trading Safe Harbour Review – October 2021.***

Notwithstanding our broad comments above, there are a number of clarifications and adjustments that could be made to improve the operation of the Safe Harbour legislation. These issues were surveyed in detail in the Review of the Insolvent Trading Safe Harbour Report dated November 2021 (the **Safe Harbour Report**) prepared by an independent panel of experts. The Safe Harbour Report made 14 recommendations to Government for legislative changes and other steps.

TMA supports the recommendations made in the Safe Harbour Report and considers that these recommendations should be implemented.

Refer ***Appendix 2.2 – Review of the Insolvent Trading Safe Harbour Report – November 2021.***

7.4 TOR 3(d) - International approaches and developments

There are a number of developments in restructuring and insolvency law and practice in various overseas jurisdictions that may improve outcomes if adopted in Australia. We set out a few such areas below, but note that TMA has not had time to undertake a proper review and consideration of all of the international approaches and developments that are worthy of consideration for adoption in Australia, and this should be subject of further review.

(a) Priority funding in insolvency

TMA considered the introduction of a priority funding regime[3] in connection with creditors' schemes of arrangement as part of TMA's submissions in response to the Government's consultation on improving creditors' schemes, where priority funding was one of the topics raised for consideration. We anticipated that the Government had in mind introduction of something similar to the priority funding provisions introduced in Singapore in connection with the broader creditors' schemes of arrangement reforms introduced in that jurisdiction. The Singapore reforms were inspired by the provisions contained in section 364 of the US Bankruptcy Code.

In our submissions, TMA expressed the view that:

- there was no sense in developing a priority funding regime only in the context of creditors' schemes of arrangement given that creditors' schemes of arrangement are infrequently used in Australia (and that funding would likely be needed prior to the point where a scheme was ready to be formally launched);
- access to interim funding to support a restructuring is important;
- given the distressed state of the company during the restructuring period, and the uncertainty as to whether a restructuring will be achieved (or the terms thereof) it is almost invariably the case that any such interim financing will only

[3] We note that there is frequent reference to introducing "DIP funding" or "debtor-in-possession funding" into Australia. This terminology is borrowed from US chapter 11 bankruptcy processes. However, this terminology is not appropriate when considering whether to adopt priority finding into the existing Australian insolvency framework as (contrary to the US chapter 11 process) Australia's insolvency processes involve external administration of the debtor company, rather than the existing boards and management of the debtor company retaining control (or "possession"). We therefore adopt the more functional terminology "priority funding", as it is this priority status for new money funding in a formal insolvency which is the key feature that those discussing reform in this space are generally seeking to introduce or enhance.

be advanced by a financier if they rank ahead of other creditors in an insolvency;

- where existing creditors have security over the assets of the company (which is frequently the case) it is generally the case that third parties will only be able to provide financing that ranks ahead of the existing secured financing with the consent of those existing secured financiers; and
- as a matter of practice, therefore, most interim financing in Australia is provided by some or all of the existing financiers (or sometimes existing shareholders). Existing financiers (or shareholders) are, in theory at least, incentivised to advance such financing if it will allow a restructuring that will result in a better recovery on their existing debt (or equity, as applicable).

At various stages there have been suggestions that introduction into Australia of a regime similar to section 364 of the US Bankruptcy Code might provide a mechanism for the court to make an order that interim finance provided by a third party to rank ahead of existing secured creditors without their consent. The advocates of such a reform hope that this would allow significant new third party financing into distressed situations.

We considered introduction of something akin to section 364 in our creditors' schemes submissions and noted that we were not yet convinced that this would make a significant difference to the existing funding dynamics outlined above.

In the US, where a company has already granted security over all of its assets to existing financiers, the only order that can be made under section 364 that will ensure priority over the existing debt is if the court grants the highest priority, allowing the company to grant a "priming lien" that ranks ahead of all existing security.

However, given the extraordinary nature of the priming lien order, and the emphasis placed on respecting property rights granted to holders of security, such an order may only be made where there is "adequate protection" of the interests of the existing secured creditor (and where the debtor company is otherwise unable to obtain such credit). We discussed the requirements to demonstrate adequate protection under section 364 in our submissions.

Given the practical difficulty in satisfying the adequate protection requirements, we understand that it is actually relatively rare for a debtor to seek a priming lien in favour of a third party in the face of objection from existing secured financiers. Instead, it is far more common for some or all of the existing financiers to extend additional funding post-petition, and for this financing to benefit from new priority security with the consent of the existing financiers (and orders to be made on this on a consensual basis). We note that this consensual option is already available in Australia.

Notwithstanding these issues, we consider that the issue of priority rescue financing is worthy of further study, as part of a more holistic review of Australian restructuring and insolvency law.

Refer to section 8.4 of TMA Submission on ***Helping Companies Restructure by Improving Schemes of Arrangement – 17 September 2021*** attached at **Appendix 5.1 & 5.2.**

Pre-packs

Pre-packs are features of some foreign restructuring and insolvency regimes. In broad terms, a pre-pack is a strategy employed to preserve value through an insolvency or

restructuring process by conducting a significant amount of the sale or restructuring work and obtaining the agreement of the required parties to implement the sale or restructuring, before the formal insolvency or restructuring process commences. This allows the formal process to be conducted rapidly with certainty of outcome, reducing broader uncertainty for suppliers and customers who may not realise the company is in significant financial difficulty until after the transaction has been completed and a solution has been implemented.

Broadly, there are two main types of pre-packs:

- pre-packaged sales – this type of pre-pack is common in the UK where a sale of the business is negotiated with a buyer prior to the appointment of administrators. The administrators sign the agreed form of sale documents immediately upon their appointment; and
- pre-packaged restructurings – this type of pre-pack involves the relevant majority of creditors agreeing to vote in favour of a particular restructuring plan prior to its launch, such that it can be implemented rapidly. One example of this is the pre-packaged plan of arrangement in respect of US chapter 11 bankruptcy processes. Another more recent example is the introduction of a streamlined process for pre-packaged creditor schemes of arrangement in Singapore.

Pre-packaged sale

In the UK, a practice has evolved of pre-packaged administrations. In such cases a (often selective or limited) sale process is conducted, and a sale contract negotiated, prior to the appointment of administrators. The sale contract is then signed by the administrators immediately upon their appointment, with completion occurring rapidly thereafter (potentially on the same day).

The process is designed to minimise the period of time where the company is in a formal insolvency process, and so that customers and suppliers only become aware of the extent of the company's problem at the time when a solution has been implemented.

A pre-pack sale seeks to minimise the usual losses of value that occur when a company enters a formal insolvency process, such as loss of customers or employees, termination of contractual arrangements, such as leasing, and other assets that are sensitive to insolvency terminations, Instead the prepack sale moves the business out of the insolvent company to new ownership rapidly, and therefore is intended to quickly alleviate the uncertainty and taint of the insolvency process.

The majority of the work related to a pre-pack sale is therefore conducted pre-appointment and is carried out confidentially by the company and its advisors (including, in particular, the "administrators in waiting"). Where there is a secured creditor, the secured creditor and its advisors may also be closely involved (particularly where the secured lender will acquire the business under a "loan-to-own" style of pre-pack sale).

The administrator in waiting is generally involved in the sale process and negotiation of the sale contract so that they can be comfortable that a suitable process has been conducted and that they will be willing to sign the sale contract upon their appointment.

Following completion of the sale, the business continues under new ownership, and the administrator deals with the creditors of the estate, any residual liquidation issues and distributes funds to creditors in due course.

Despite these benefits, pre-packaged sales in the UK continue to be somewhat controversial, with concerns about the sale process being conducted in secret and presented to creditors as a "fait accompli". Often pre-pack sales are made to the existing

owners of the business, and this can lead to concerns that such transactions favour them at the expense of creditors (i.e., they may raise similar concerns to phoenix transactions in Australia). Supporters of pre-packs assert that despite these concerns, pre-packs, where properly conducted, generally result in the best outcome for creditors and the least damage to the business.

Various measures were introduced in the UK to address the concerns around pre-packs, while at the same time seeking to preserve their potential benefits. These measures have had mixed reception. This has led the UK government to recently introduce the *Administration (Restrictions on Disposal etc. to Connected Persons) Regulations 2021* (UK) that came into force in April 2021. Under the new regulations, an administrator must not dispose of all or a substantial part of the company's business and assets to a "connected person" within the first eight weeks of administration unless either: (i) the company's creditors have approved such disposal; or (ii) an independent and suitably qualified "evaluator" has given a "qualifying report" stating that it considers the consideration for the disposal to be reasonable.

TMA believes that the UK approach to pre-packaged sales, and whether it would be appropriate to adopt a similar approach in Australia in respect of voluntary administrations, should be considered as part of a broader holistic view of Australia's insolvency regime.

However, we note that for a UK style pre-pack administration sale to occur in Australia, there would need to be consideration of how this process would work within the broader Australian legal framework. In particular, TMA are of the view that introducing such a practice would require:

- re-appraisal of the independence rules for administrators, which currently constrain the extent to which administrators could be involved in undertaking a sale process and negotiating a sale agreement prior to their appointment;
- consideration of the current role of the second meeting of creditors in voluntary administrations, where creditors are entitled to vote on the future of the company including any DOCA proposal. Indeed, the Australian administration regime currently emphasises the use of the DOCA as the restructuring exit pathway from administration. While an administrator can conduct an asset sale prior to the second creditors' meeting, this is less common. Facilitation of pre-packaged sales by administrators' immediately upon the company entering into administration would deprive creditors of their decision-making powers and may also result in DOCAs becoming significantly less utilised; and
- consideration should also be given to how undertaking a pre-appointment pre-packaged sale process would interact with Australia's insolvent trading and Safe Harbour requirements (noting that Safe Harbour processes typically focus on avoiding formal insolvency, and the Safe Harbour requirement that the course of action be reasonably likely to result in a better outcome for the company which would typically be liquidated following conclusion of a pre-pack sale process).

Pre-packaged restructurings

As noted above, pre-packaged restructurings generally involve the formulation of a restructuring plan and pre-commitment to vote in favour by a necessary majority of creditor to approve that plan under the formal legislative requirements.

It is worth noting that in Australia we do already on occasion see parties formulating DOCAs and agreeing to vote in favour of such DOCAs prior to the appointment of

administrators. Similarly, parties often seek to "secure" the relevant majority of scheme creditors prior to launching a scheme of arrangement process. However, there is no specific legislative recognition of these arrangements in Australia, and no provision for short cutting any of the formal steps required on those processes where the requisite majority has already approved the DOCA or scheme at the outset of the process.

In contrast to this approach, in Singapore statutory provisions have been introduced for a pre-packaged creditors' scheme of arrangement process. A pre-packaged scheme of arrangement is intended to allow the scheme of arrangement process to run more quickly, efficiently and cheaply in circumstances where a sufficient majority of creditors to pass the scheme have already committed to support the scheme before the formal process starts. Where appropriate disclosures have been made, and the requisite majority of creditors approve the scheme, the first court hearing (at which the court normally makes orders to convene the meeting of creditors) and the meeting of creditors may be dispensed with, and the court simply decides whether to approve the scheme at a single court hearing.

A number of pre-packaged schemes of arrangement have now been undertaken in Singapore, and the feedback we received from Singapore professionals when preparing our submissions on creditors' schemes of arrangements generally seemed positive. However, this should be revisited to determine how the Singapore pre-packaged scheme has operated and evolved since our previous discussions.

We recommend that the Government consider whether pre-packaged schemes should be introduced in Australia. This will require further analysis, including considering how a pre-packaged scheme would interact with other reforms being considered.

Refer to section 8.8 of Appendix 6.2 - TMA submissions - Helping Companies Restructure by Improving Schemes of Arrangement

Cross-class cram downs for creditors' schemes of arrangement

TMA recommended in its submissions *Helping Companies Restructure by Improving Schemes of Arrangement* to the Treasury that Australia should introduce a "cross-class cram down" for creditors' schemes of arrangement modelled on the recently introduced UK "restructuring plan", as provided for under Part 26A of the UK Companies Act.

Under existing law, Australian creditors' schemes of arrangements only allow intra-class cram downs — i.e., the ability to bind dissenting minorities within the same creditor class. Generally, this means that senior lenders are unable to bind junior creditors or shareholders to a creditors' scheme of arrangement, even where those junior creditors or shareholders are "underwater" and cannot expect to receive anything upon the insolvency of the company.

A cross-class cram down mechanism would allow financial restructurings of distressed companies to be undertaken more efficiently. It would allow claims of junior creditors and shareholders that are "underwater" to be extinguished without their consent. This in turn would avoid the necessity of "consent payments" or other value being siphoned off to parties who no longer have any real economic interest in the business.

With respect to shareholders, this would be consistent with the approach already taken under DOCAs, where section 444GA can be used to compulsorily transfer shares that have no economic value.

TMA believes that an efficient, predictable and fair cross-class cram down (with appropriate safeguards) will result in better restructuring outcomes. This will benefit not only the lenders directly participating in the restructuring, which are often secondary market distressed fund investors, but also primary lenders who can expect to receive better pricing when they sell their debt as a result.

Refer to sections 7.1 to 7.8 of Appendix 5.2 - TMA submissions on improving creditors' schemes of arrangement.

Introduction of a debtor-in-possession regime

In TMA's submissions entitled "Helping Companies Restructure by Improving Schemes of Arrangement" dated 17 September 2021, TMA considered the introduction of a debtor-in-possession style restructuring regime in Australia, which would include a general moratorium on creditor action against the company while a restructuring was formulated and implemented. TMA took the view that any consideration of adoption of a debtor-in-possession regime in Australia would necessitate a holistic and thorough review of Australia's restructuring and insolvency framework.

There are now a variety of debtor-in-possession models that have been adopted in other jurisdictions. These could broadly divide into:

- court based models, such as Chapter 11 of the US Bankruptcy Code, where the courts provide primary oversight of the debtor company; and
- insolvency practitioner models, such as the UK's Part A1 moratorium process, where an insolvency practitioner monitors the activities of the debtor company and must provide consent to certain actions.

There are variations on these approaches, which may involve greater or lesser oversight or where there is a combination of court and insolvency practitioner oversight. However, as discussed in our previous submissions, we consider that ensuring there is appropriate oversight and governance is critical to ensuring a debtor-in-possession process that engenders confidence and trust from creditors and the broader community.

We have considered some of the key considerations in connection with the introduction of a debtor-in-possession regime in our previous submissions, and surveyed the approaches taken in a number of other jurisdictions. We recommend that these issues be further considered as part of a general review of Australia's insolvency and restructuring framework.

Refer to Appendix *5.2 - TMA's submissions entitled "Helping Companies Restructure by Improving Schemes of Arrangement" dated 17 September 2021*

8 TOR 4: Supporting business access to corporate turnaround capabilities to manage financial distress

There is limited guidance for directors in relation to turnaround and governance in the period of underperformance or financial stress prior to formal insolvency. The existence of the Safe Harbour regime has gone some way to encourage directors to act earlier and to implement a framework, however, it is important to note that ultimately Safe Harbour is a defence to insolvent trading so there needs to be a broader educational piece as to how directors approach financial stress. Education and awareness are critical to ensure that directors understand where to seek help, appropriate governance in relation to distress, the skill sets and capabilities that are needed to manage through those processes, and how to approach difficult discussions and decisions that need to be navigated at the board and management level.

We consider that the role and benefit of the turnaround manager or the chief restructuring officer (**CRO**) is not well understood by corporate Australia. This is despite such roles being commonplace in a number of sophisticated overseas markets such as the US. In

those markets, turnaround managers and CROs are seen as critical in allowing businesses to proactively respond to financial distress and address the issues in the business at an earlier stage (typically with a more holistic and commercial approach), before formal insolvency proceedings become inevitable. As TMA emphasises, early intervention allows businesses significantly more opportunity to turnaround a business and ultimately results in better outcomes for stakeholders.

Unfortunately, it can be difficult to convince Australian directors or management to seek outside assistance to address these issues at this earlier stage. We therefore think that it is important to consider how the role of the turnaround manager or the CRO can be encouraged and utilised more broadly in Australia. We consider this is predominantly a cultural and educational issue for corporate Australia, rather than something requiring legislative response. However, we expect the Government nonetheless has a role to play in encouraging this market shift, together with industry bodies. Consideration should also be given as to whether any elements of the legislative framework are acting as 'blockers' or otherwise disincentivising the engagement or turnaround managers and CROs, and whether lessons can be learnt from studying the experience in overseas jurisdictions where turnaround managers and CROs are more widely accepted and utilised.

TMA has been advocating this evolution in the Australian market for some time, and would welcome the opportunity to engage with the Government and other bodies on how this holistic and proactive approach to business rescue and turnaround can be more widely adopted in the Australian market. We strongly believe that to do so will result in better outcomes for Australian businesses, and all of their stakeholders, including creditors, shareholders, employees and customers.

9 TOR 5: The role, remuneration, financial viability, and conduct of corporate insolvency practitioners (including receivers, liquidators, administrators, and small business restructuring practitioners)

These matters are outside the scope of TMA's objects, and we do not provide comment upon them.

10 TOR 6: The role of government agencies in the corporate insolvency system

10.1 TOR 6(a) - the role and effectiveness of ASIC as the corporate insolvency regulator

In the time available for comment, TMA has not focused on developing a response to this matter given that this issue is typically less central to TMA's objectives than other matters referred to in the TOR.

Having said that, we understand that there is some suggestion that ASIC's responsibilities as an insolvency regulator is transferred to AFSA. We think that any such proposal should be considered carefully, particularly whether there is any real benefit in doing so, with the potential cost and disruption involved. We also note that there is a clear

overlap in dealing with corporate and financial market regulations as well as corporate distress and insolvency.

In respect of the current effectiveness of ASIC as the primary regulator of restructuring and insolvency, TMA is of the view that it would be beneficial for ASIC to be more proactively engaged with business professionals in respect of:

- better education on insolvency practices and procedures with a focus on raising awareness to the early signs of insolvency and the available pathways forward; and
- current regulatory frameworks and any future changes in this space.

In our experience, promotion of early intervention practices and encouragement by ASIC of business professionals seeking proper advice at an early stage makes a significant difference to more efficient and successful outcomes. This was previously a role that the National Insolvency Coordination Unit played within ASIC, and we would recommend that something similar be considered in any upcoming review.

10.2 TOR 6(b) - the ATO's role and enforcement approaches to corporate insolvency, and relevant changes to its approach over the course of the COVID-19 pandemic

In the time available for comment, TMA has not focused on developing a response to this matter given that this issue is typically less central to TMA's objectives than other matters referred to in the TOR.

10.3 TOR 6(c) - the role, funding and operation of relevant bodies, including the Assetless Administration Fund and the Small Business Ombudsman

In the time available for comment, TMA has not focussed on developing a response to this matter given that this issue is typically less central to TMA's objectives than other matters referred to in the TOR.

It is unclear how much overlap there is in practice between personal insolvency regulation and corporate insolvency, other than in respect of MSMEs.

11 TOR 7: Any related corporate insolvency matters

A number of potential legislative issues which require more in-depth review and possible reform have been identified by our members as set out in the follow subsections.

Voluntary administration

Voluntary administration should undergo a general review, including in respect of the following issues:

- time periods and the ease of obtaining extensions of the period to convene the second meeting of creditors (including for example, whether such extensions could be approved by the committee of inspection rather than requiring a court order);
- which circumstances require court approval; and

- streamlining funding.

In particular, consideration should be given to the personal liability of administrators under section 443A of the Corporations Act for various categories of debts incurred by the company during the administration. Section 443A(2) provides that administrators cannot contract out of this personal liability. This results in administrators frequently making court applications under section 447A of the Corporations Act for orders modifying the operation of section 443A in respect of funding or other contracts being entered into by the administrators. Typically, such orders provide that the liability of the administrator is limited to the value of the company's assets that are available to indemnify the administrator in respect of such liability.

Such applications involve significant time and cost, although the orders are routinely made by the courts on the terms sought by the administrators. We therefore consider that this current regime involves significant waste, and that the relevant provisions should be amended.

One option is that the wording of sections 443A (and potentially 443B) be amended such that the administrator is liable only to the extent of the value of the company's assets, which is typically what administrators seek from court orders (or, as suggested by Jason Harris in his PhD thesis, that creditors may approve such a limitation either in a meeting or through the committee of inspection).

Alternatively, consideration could be given to enacting a priority expenses regime which does not depend on the personal liability of the administrator at all (akin to the approach in the UK).

Modifications to DOCAs

The DOCA framework is currently relatively simple and, in many circumstances, works quite well. However, there are things that cannot be achieved under a DOCA, such as releasing claims of creditors against third parties (such as guarantors), extinguishing securities or modifying, terminating, remedying or transferring contracts or leases as part of a broader reconstruction. Consideration should be given as to whether there is merit in allowing DOCAs to do some or all of these things (and if so what further requirements and protections might be required in connection with their use).

Similarly, consideration should be given to whether the legislation needs to be more prescriptive in respect of any mandatory requirements of DOCAs (including, for example, any requirements as to priority treatment of costs incurred during the administration period).

Likewise, creditor protections should also be reviewed.

The main protection that the Corporations Act provides creditors and others affected by a DOCA is to seek an order of the court terminating the DOCA under section 445D. Such an order can be made on the various grounds set out in that section, including where it is unfairly prejudicial to or unfairly discriminatory against one or more creditors. However, section 445H provides that termination of a DOCA does not affect its previous operation. Therefore, to the extent that the DOCA has already taken effect, the remedy will be ineffectual (it is also notable that there is no general requirement that a DOCA not be unfairly prejudicial or unfairly discriminatory – these are merely grounds for termination of the DOCA).

This is potentially problematic as DOCAs are now frequently being formulated that have immediate effect upon their execution. This is achieved by having any debt compromise take immediate effect under the DOCA but having any distribution to creditors occur at a

later date under a creditors' trust deed. This structure has the benefit of taking the company out of administration, and allowing it to return to normal operation, immediately. However, it also limits the ability of creditors to effectively challenge a DOCA after the occurrence of the second creditors' meeting.

Voting by creditors on whether to approve a DOCA currently occurs in a single class. All creditors, whether secured, unsecured or preferential, vote together. While this has the advantage of simplicity, the interests of these creditors may not always be aligned. Secured financial creditors frequently have significant influence on the process given the size of their claims (which they can vote in full even when fully secured) and the fact that section 444D(2) protects the secured creditors' rights to enforce its security (which in substance frequently gives the secured creditor a veto right). Further, there is scope for differential treatment of creditors under a DOCA notwithstanding the single voting class.

We think it would be appropriate, as part of a holistic review, for consideration to be given to the dynamics of creditor voting and whether it would be appropriate to introduce class voting requirements in any circumstances (and if so, to what extent this would be subject to a cross-class cram down power).

Stand-alone DOCAs without voluntary administration

DOCAs can provide distressed companies with a relatively simple avenue to restructure their debts and obtain a "fresh start". However, at present DOCAs may only be undertaken by a company within voluntary administration. Voluntary administration can be a costly and disruptive process. Further, it can only be accessed by a company's directors where they consider the company is insolvent (or is likely to become so).

In our view, it would be helpful to have the additional flexibility to allow companies to undertake DOCAs in appropriate circumstances outside of voluntary administration.

In the UK, this is possible through the company voluntary arrangement (**CVA**) procedure which is in substance quite similar to the DOCA procedure. However, in the UK, companies may formulate and implement a CVA proposal without having to appoint administrators.

Introducing a stand-alone DOCA process in Australia akin to the CVA in the UK could provide companies experiencing moderate levels of financial distress with an alternative tool to repair their balance sheet without attracting the stigma and cost that is often associated with appointing administrators. The details of any such standalone DOCA regime would need to be considered carefully.

Jason Harris makes a recommendation of such a nature at Recommendation 15 in his PhD thesis "Promoting an Optimal Corporate Rescue Culture in Australia: the Role and Efficacy of the Voluntary Administration Regime" In his view, the process of administration brings damage to the company's goodwill that could be avoided if the company were able to simply present a DOCA to creditors without going through several weeks of administration.

Issues relating to creditors' schemes of arrangements

We have identified a number of issues, and made various recommendations, in respect of creditors' schemes of arrangement in our previous submissions entitled "Helping Companies Restructure by Improving Schemes of Arrangement" dated 17 September 2021. Those recommendations included:

- introduction of a cross-class cram down (see discussion above);
- introducing of a practice statement in Australia to ensure creditors have appropriate notice of the matters to be addressed in the first court hearing;

- streamlining the ASIC review process for schemes of arrangement;
- extending the scheme jurisdiction to foreign companies with sufficient connection to Australia;
- requiring the filing with ASIC and public disclosure of scheme documentation to improve corporate transparency and disclosure;
- considering removal of the "headcount test" as a requirement for scheme approval.

Refer to sections 8.1 to 8.9 of Appendix 5.2 ***TMA's submissions entitled "Helping Companies Restructure by Improving Schemes of Arrangement" dated 17 September 2021***

Jurisdiction and cross-border insolvency

Currently in Australia, insolvency processes are only available in administrations or schemes for entities that have been incorporated or registered in Australia. Foreign companies cannot access the Australian restructuring provisions, even where they have significant operations in Australia or where the foreign entity is part of a broader Australian corporate group, where it would be useful to deal with the foreign entities under the same process. Many foreign jurisdictions have much broader tests, which often come down to a sufficient connection with the relevant jurisdiction in question. It would be helpful to consider an expansion of the Australian provisions to allow for these companies to utilise Australia's processes in the appropriate circumstances.

Similarly, consideration should be given to whether Australia should adopt the UNCITRAL Model Laws on Enterprise Group Insolvency or the UNCITRAL Model Law on the Recognition and Enforcement of Insolvency-Related Judgments and whether Australia still supports retention of the rule of private international law in *Antony Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux* (1890) LR 25 QBD 399 (known as the rule in *Gibbs*) which provides that debt can only be discharged pursuant to a process under or in accordance with the governing law of the contract under which the debt arises.

Corporate groups

Consideration should also be given to whether any further steps or reforms should be undertaken to address insolvency and restructuring of corporate groups. Existing corporate insolvency legislation largely focuses on companies individually. In reality though, almost all large corporates operate as part of corporate groups, and any insolvency will generally need to resolve or address the corporate group as a whole. There are obviously limits as to what can be done while preserving the concept of limited liability and separate legal entity, which are core to the idea of a company. However, various work has been done in recent years to examine how to facilitate group insolvencies and restructurings from a more practical administrative process and reduce unnecessary costs. We would recommend that a similar exercise be undertaken in Australia to identify where adjustments should be made.

Ipso facto stay regime

The ipso facto stay regime applicable to administrations, certain receiverships and schemes of arrangement, came into effect in 2018. The effectiveness of the regime in practice is highly questionable given the significant number of exceptions to the ipso facto stay, its relatively limited ambit and the lack of a mechanism to remedy contractual breaches or assign contracts to third parties (which are features of the ipso facto regime under the US Bankruptcy Code).

We recommend that the operation of the ipso facto stay and further reforms to make it operate more effectively be considered as part of a further holistic insolvency and restructuring review process.

The role of receivership and secured creditors

Consideration should also be had as to whether Australian law provides for an appropriate balance of control between secured creditors and others during an insolvency process. For example, in the UK, administrative receiverships (where a receiver is appointed over the whole of the assets of the company) were effectively abolished in 2002 in favour of the broader use of the administration regime. Further, in Australia we now frequently see both receivers and administrators appointed to companies simultaneously, which results in increased costs (whilst noting that in such scenarios administrators typically play a fairly limited role unless a DOCA is being proposed or implemented).

Whilst this issue has previously been debated in Australia, we note that there have been significant behavioural changes in the Australian market since this question was last considered, and that this issue is worth further consideration.

There is also a question of whether there should be a "cut-off" such that a security interest ceases to attach to new assets of the company (that are not proceeds of existing secured assets) that come into existence after the date of administration, similar to the way in which security interests are limited under section 552 of the US Bankruptcy Code. It seems debatable from a policy perspective whether a secured creditor should continue to obtain priority to new assets that come into existence after the date of formal insolvency regardless as to whether that asset has been funded by the secured creditor or from some other source. A cut-off of this type might open up additional sources of collateral or value for administration priority funding. However, such a provision may also discourage existing lenders from advancing further funds to a company in administration unless they obtain a further post-administration security interest to cover the assets not covered by the pre-administration security (a practice common in the United States). This could be a disincentive to lending or merely result in further time and cost.

These issues would be worthy of consideration as part of a broader review.

Conflicts of interest

Whilst there is some allowance for pre-appointment involvement of a proposed appointee, it is limited, and the Australian regime significantly biases toward preserving independence of appointees in formal appointments. That is, if an advisor "crosses the line" prior to the appointment of a VA and gets too involved with the implementation of a restructure, they can be conflicted from acting as the administrator.

Whilst independence is arguably a desirable requirement of an incoming administrator, significant time and cost is expended in "re-educating" the independent administrator when they are appointed. In the US in particular, it is seen as desirable that the restructuring advisor has been involved with the company for some time, and it is perceived that this involvement will likely result in a superior outcome for creditors, at a likely lower cost.

There are provisions that allow for the appointment of a "special purpose" appointee for matters of controversy, but it has not been used often enough. The preference appears to be to remove the administrator entirely, which results in higher costs which are borne by the creditors. In the Ten Group matter, a special purpose liquidator was appointed to

review the areas that created potential conflict. As part of a review TMA recommends an examination of the independence and conflicts rules relating to appointments of administrators and other roles including, in particular, where an insolvency practitioner has given advice in connection with a restructuring or safe harbour plan prior to administration. Consideration should be given to where the real risks arise from such cost and efficiency trade-offs. The greatest danger would appear to be incentivising insolvency practitioners to give advice leading to formal insolvencies where that was not necessary or desirable due to the potential for the insolvency practitioner to receive a larger role and higher fees as an administrator or liquidator and this would need to be carefully considered as part of assessing the independence framework.

Gender diversity in the profession

ASIC's July 2022 Quarterly statistics show that of 664 registered liquidators in Australia only 59 (c.9%) of them were female. Clearly, there are systemic diversity issues within the insolvency and restructuring industry.

TMA has consulted with various female members to identify contributing factors which has resulted in the large disparity between the number of male and female registered liquidators. The specific issues that need to be addressed are:

- A need for 4,000 working hours of experience, given carer responsibilities and time taken for parental leave
- The 5-year time cut off for this experience, particularly problematic where this coincides with starting a family
- The Temporary COVID-19 measures which reduced the number of appointments. This affected the ability of any person in the industry to gain the relevant experience but was even more difficult for women that were working part-time or who took parental leave in that time.
- With the onset of COVID-19 there has been a general trend toward consensual restructures, which further reduced the ability of people to gain formal insolvency experience. Again, this makes the criteria even more difficult for working mothers who work part-time or who took parental leave.
- The ASIC regulatory arrangements allow for discretion to be applied; however, our member's experience is that it has been inconsistently applied and poorly communicated.

Ann Watson and Georgia Gamble from the law firm, Hall & Willcox, have provided a comprehensive summary of the issues. With their permission, this summary is attached as ***Appendix 4.***

General Tax Efficiency Review

TMA considers that there would be merit in conducting a general review as to whether restructuring can be carried out in a tax-efficient manner, or whether reform can be made so that there are no tax disincentives to the restructuring process. In particular, this review should focus on:

- whether raising new capital, either by debt or by equity, can be undertaken in a manner that is tax efficient and encourages investment;
- change of control transactions;
- whether any relief can be provided from state and federal transactional taxes, which can be a barrier to getting funds into an already difficult situation; and

- whether tax losses can be retained as part of the process involved in implementing Deeds of Company Arrangement throughout a restructuring.

Capital raising modifications

During COVID there were arrangements made to ease the administrative burden of capital raising, to allow funds to flow more easily to companies. This assisted a number of companies to survive and was effective in helping them turnaround. The Inquiry should consider whether there is an ability to promote low-doc capital raising and post raise cleansing in distressed situations (with ASIC and, if dealing with a listed company, securities exchange approvals). Such capital raises would need appropriate safeguards, but given that time and cash are so important to successful turnarounds, TMA considers this to be an important area of inquiry when considering a holistic review of Australia's insolvency laws.

12 Acknowledgments

TMA would like to acknowledge a number of our members that contributed to this submission.

Through our Chair, Jennifer Ball and our President, Maria O'Brien, we are prepared to make ourselves available for any consultation you would like from us in relation to this submission.

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Appendices

1. **TMA KordaMentha Survey 2022**
2. **TMA Submission to the Review of Insolvent Trading Safe Harbour - October 2021**
3. **ASIC Insolvency Statistics**
4. **Note from Georgia Gamble, Hall & Willcox re: Criterion for Registration as a Liquidator – October 2022**
5. **TMA Submission - Helping Companies Restructure by Improving Schemes of Arrangement – September 2021**

5.1 Covering Letter

5.2 Submission

5.3 Article "Singapore's new "supercharged" Scheme of arrangement"

6. **TMA Submission on Corporations Amendment (Corporate Insolvency Reforms) Bill 2020 Exposure Draft – October 2020**

KordaMentha – TMA Australia
2022 Turnaround Survey

November 2022

TMA Australia | KordaMentha

Introduction

The annual KordaMentha – TMA Survey provides insights from the last 12 months, and a perspective on the business and turnaround outlook beyond 2022.

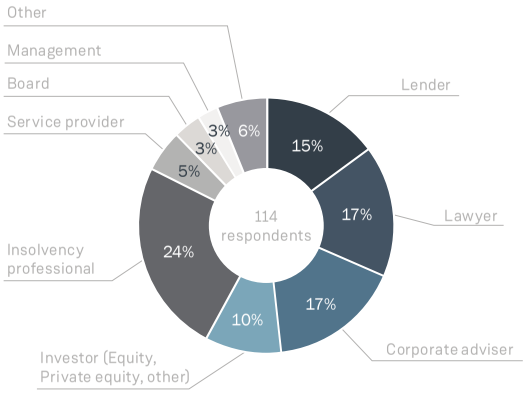
KordaMentha, in conjunction with the Turnaround Management Association of Australia ('TMA'), surveyed Australian turnaround professionals for their insights on the response to COVID-19 and the outlook for the next 12 months.

The results of the survey have now been tallied and summarised into the following topics:

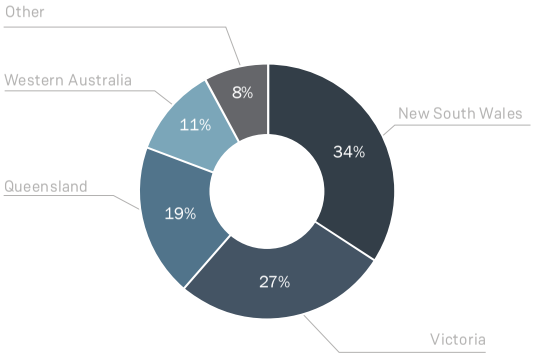
- Market outlook.
- Australia's insolvency environment.
- The current turnaround environment:
  - drivers of distress
  - access to financing.
- Expected response from businesses.
- Expected response from financiers.

Profile of respondents

By profession



By state



KordaMentha

Key insights

The 2022 KordaMentha – TMA Survey respondents anticipate more distress in the market as inflation and interest rates rise and governments prioritise fiscal responsibility. Despite this, responses to most questions were balanced and did not show an overwhelming majority, suggesting there is far more uncertainty in the year to come.

61%

Anticipate a recession in the next 24 months, with a third of respondents anticipating a recession within 12 months.

70%

Believe that insolvency appointments will return to pre-COVID levels within the next 12 months.

63%

Believe rising input costs and workforce retention and attraction are the biggest pressures to businesses. Supply chain delays continue to be an issue according to 53% of respondents.

59%

Believe cost reduction initiatives will be highly important for their clients in the coming year. Cost is not the only focus, with almost half of respondents believing revenue growth will be of high importance to their clients.

88%

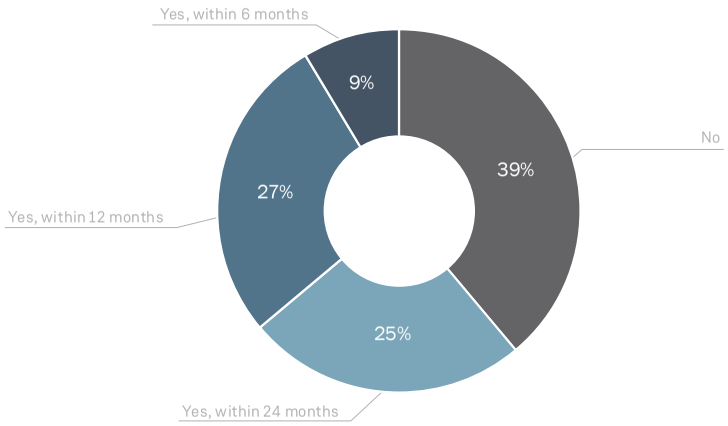
Believe the most common response to distress by lenders and owners will be to explore options outside of formal insolvency appointments. Most respondents also believe that M&A transactions relating to distressed assets will increase over the next 12 months.

Market outlook: Economic environment

Despite high inflation and increasing interest rates, only 61% of respondents anticipate a recession in the next 24 months, with a third of respondents anticipating a recession within 12 months. A majority of respondents anticipate that inflation will increase for the next 12 months, but most believe this will not significantly impact their clients.

Recession

Do you anticipate a recession in Australia?

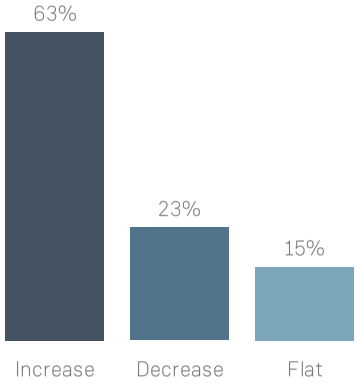


There were mixed views on whether Australia will enter a recession. While a slight majority do anticipate a recession, only 9% felt this would occur in the next six months.

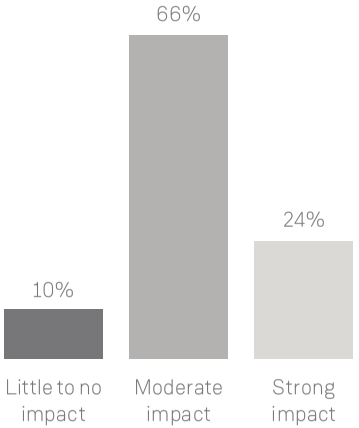
This suggests a belief from respondents that, at least in the short term, the Reserve Bank of Australia's management of interest rates in response to inflation will not result in a major slowdown of Australian's economic activity.

Inflation

What do you expect the inflation trend to be in the next 12 months?



What impact will the inflation trend have on your clients' businesses?



A majority of respondents believe inflation will increase in the next 12 months. 90% of respondents also felt that inflation will have a moderate or strong impact on their clients' businesses.

KordaMentha

Australia's insolvency environment: A return to 'normal'?

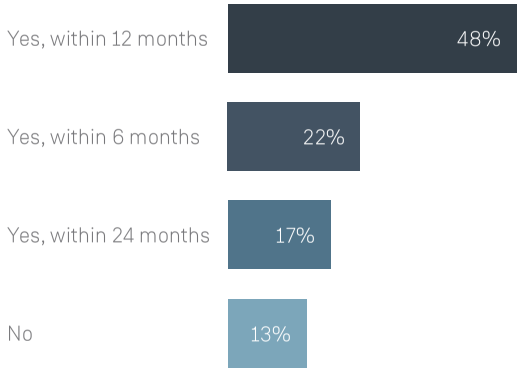
After nearly two years of historical lows, monthly formal insolvency appointments increased substantially throughout 2022 and by July were at their highest level since November 2019. 70% of respondents believe that insolvency appointments will return to pre-COVID levels within the next 12 months.

"The 2022 increase is relative to historical low volumes during COVID due to government support, low interest rates and a lack of enforcement from lenders and creditors – all contributing to the continuation of zombie companies.

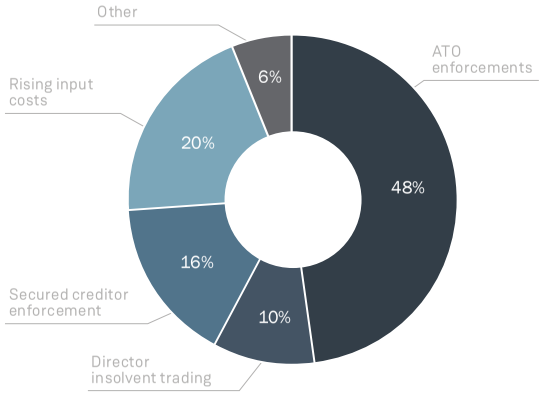
The recent increases have been at the smaller end of the market, driven by the ATO action on Director Penalty Notices and cost pressures. We expect this activity to continue at the SME level and in 2023, to extend to larger enterprises as inflation, supply chain challenges, increasing interest rates and declining consumer confidence start to impact margins and forecasts."

Sebastian Hams
Partner
Restructuring

Will the number of monthly insolvency appointments reach pre-COVID levels?



What will be the most influential trigger for formal insolvency appointments in the next 12 months?



In last year's survey, unexpected continuations of lockdowns and subsequent government support were highlighted as key factors why the number of external administrations remained low. The end of ultra low interest rates and rise of inflation is reflected by ASIC insolvency data showing a spike in appointments from April 2022.[1]

Looking ahead, respondents believe that the return to historical levels of administrations will continue, and that ATO enforcements will be a key driver of formal insolvency appointments, followed by rising input costs and secured creditor enforcement.

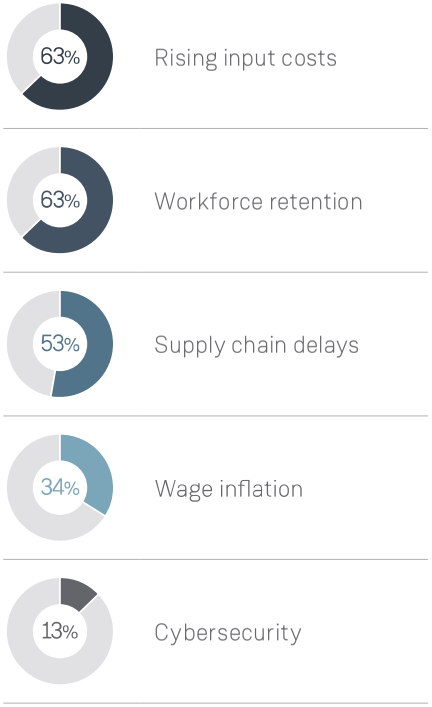
[1]ASIC insolvency statistics, September 2021

KordaMentha

Current turnaround environment: Drivers of distress

Inflation, workforce pressures, interest rates and supply chain delays continue to impact businesses in all industries. Cybersecurity is becoming an emerging issue and is now considered to be a significant cause of financial pressure by 13% of respondents.

Top five factors causing significant pressure to business



In our 2021 survey, respondents expected that border closures, recruitment, and supply chain delays would be of most concern to business, with traditional pressures such as rising input costs viewed as secondary.

In this year's survey, rising input costs were viewed as the most significant factor causing pressure on businesses, with the challenges of workforce retention and supply chains also persisting.

"The increasing concern about cybersecurity is directly aligned with a steep rise in cyber incidents over the past few years. In 2022, the average total cost of a cyber breach has grown to $4.2 million, the government has introduced sweeping cyber legislation and regulators such as ASIC and APRA are starting to actively enforce minimum security standards. More change is expected in the wake of the recent Optus breach that may cost the company hundreds of millions of dollars.

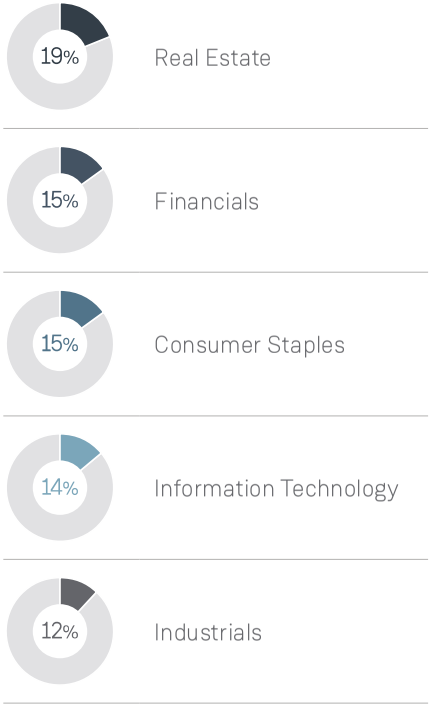
Several class action lawsuits are ramping up and new privacy legislation that aligns with Europe is expected, where breaches can result in **significant** fines. All these forces will add additional pressure to organisations in the future, continuing to make cybersecurity a key business risk."

Eric Eekhof
Partner
Cybersecurity

Current turnaround environment: Drivers of distress

19% of respondents believe the Real Estate sector will face the most distress, but this is closely followed by Financials, Consumer Staples, Information Technology and Industrials. Responses continue to confirm that distress is not isolated to discrete sectors within the economy.

Top five sectors facing the most distress



Although Real Estate was viewed as the most distressed sector, responses indicate that this distress was not isolated.

Respondents considered the broad impacts of rising input costs, workforce challenges, supply chain delays and wage inflation are also impacting businesses across Financials, Consumer Staples, Information Technology, Industrials and Telecommunications sectors, which all ranked highly compared to previous surveys.

> Headlined by rising construction costs and interest rates, the broader real estate market is facing several headwinds which point to challenging times ahead. Despite the headwinds, distress remains relatively low with high levels of liquidity and an active refinancing market.

Ted Fitzgerald
Partner
Real Estate

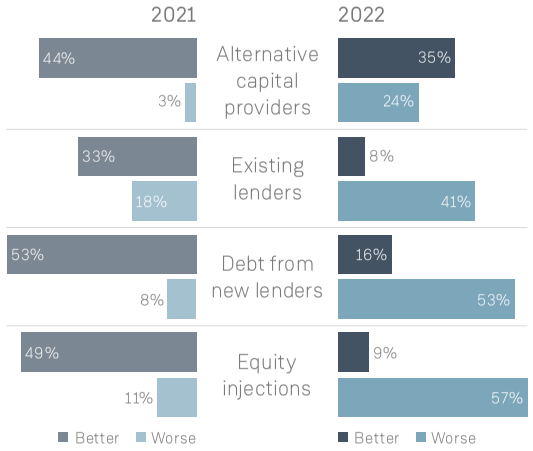
Current turnaround environment: Access to financing

63% of respondents noted that Environmental, Social and Governance (ESG) considerations are becoming more important for lenders. This change is occurring in a market where the availability of finance is tightening. Respondents stated overwhelmingly that financing conditions were far worse than last year in all classes, with the only exception being alternate capital providers.

> ESG focussed lending is both a risk mitigation tool and an attractive marketing tool to communicate a commitment to sustainability.
>
> For borrowers, ESG linked debt will continue to grow in popularity and prevalence, particularly where margin reductions occur on achievement of ESG focussed KPIs. However, with many corporates facing an abundance of pressures, including volatility and cost of capital escalations, there is an increasing tension between obtaining capital at its lowest possible cost, whilst pursing longer term ESG sustainability targets.

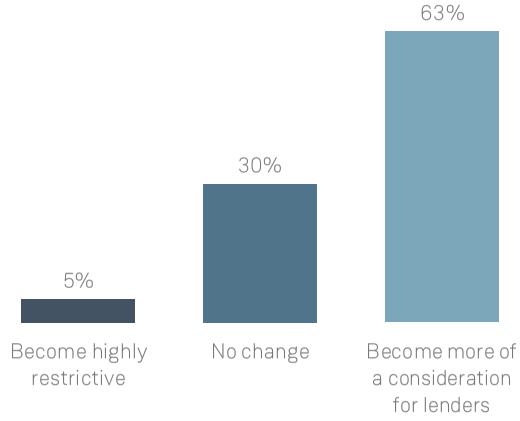
Kate Conneely
Partner
Restructuring

How have organisations' ability to secure the following external debt or equity finance changed over the last 12 months?



Respondents believe that organisations' access to all forms of debt or equity financing had become more challenging in the last 12 months, with the largest deterioration in equity injections and debt from new lenders. This reflects an environment where businesses face challenges refinancing and raising additional funds, and is likely contributing to the increasing number of formal insolvency appointments.

How have ESG considerations impacted companies seeking refinancing or recapitalisation over the last 12 months?



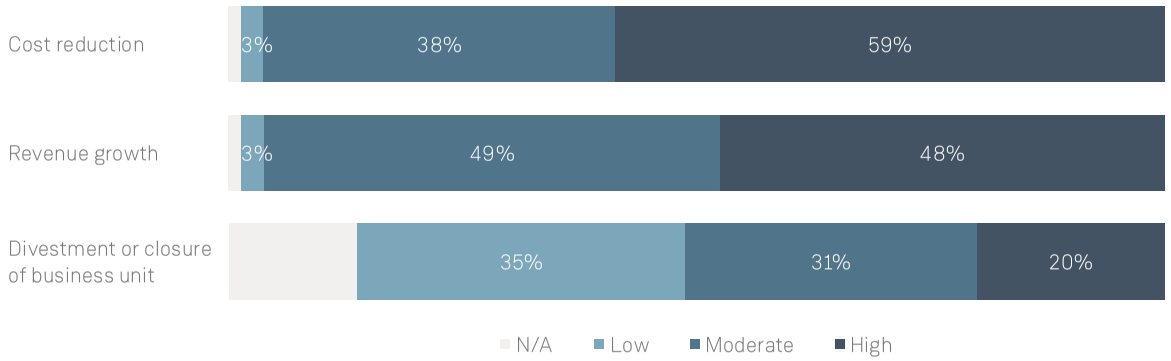
While 30% of respondents felt there had been no change, the majority of respondents felt ESG factors were becoming more of a consideration for lenders.

In an environment of decreased liquidity, businesses that can demonstrate strong ESG practices may be able to gain more traction with financiers.

Expected response from businesses

59% of respondents believe cost reduction initiatives will be highly important for their clients in the coming year. Cost is not the only focus though, with almost half of respondents believing revenue growth will also be of high importance to their existing clients. The even balance of responses highlights the tension between growing in a strong economy and becoming more efficient in an inflationary environment.

What is the importance of each of the following initiatives for your clients over the next 12 months?



Responses in the 2022 survey suggest businesses must consider both revenue and cost initiatives to manage through the current economic challenges.

- In our 2020 COVID-19 survey 85% of respondents viewed cost reduction initiatives as high importance, compared to 59% this year.
- Revenue growth initiatives were viewed as of similar importance to prior years, with slightly less than 50% of responses considering it of high importance.
- Initiatives relating to the divestment or closure of business units have decreased in relative importance, with only 20% of respondents believing this to be of high importance (down from 65% in 2020). This highlights the change in environment since the onset of COVID-19. The spread of responses also suggests that this initiative is contingent on the context and performance of a given business.

> The fact divestments of non-core assets are not viewed as important suggests balance sheets remain strong and liquidity is still available.
>
> We have recently starting seeing more cost reduction and efficiency programs as inflation and interest rates put pressure on margins. However, companies are still very focused on revenue and growth given strong consumer demand. Whether this dynamic shifts is a key unknown to play out over the next year.

James Wagg
Executive Director
Performance Improvement

KordaMentha

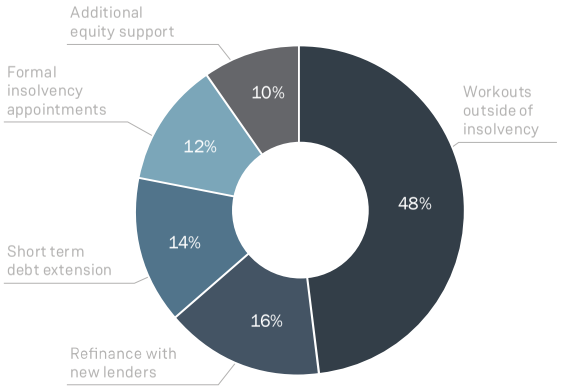
Expected response from financiers

Respondents overwhelmingly believe that new debt and equity will be available in capital markets, avoiding the need for formal insolvency as a solution to distress. The availability of capital is predicted to lead to more distressed M&A transactions according to 73% of respondents.

> It's no surprise that exploring restructuring options outside of a formal appointment will be a preferred pathway forward, however, with the business terrain getting more challenging by the day – interest rates, supply chain, labour shortages, cost increases – purchasers of debt and equity need to get confidence in valuations to avoid formal processes.
>
> The biggest restriction in both debt and equity M&A transactions is the lack of confidence in the medium term valuations. This could be accelerated by vendors pricing in these future risks and reducing price expectations, but we are seeing no signs of that yet.

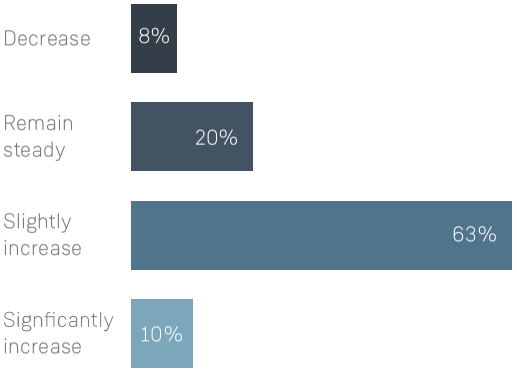
Scott Langdon
Partner
Restructuring

What do you think the most common response to distress will be by lenders and owners?



48% of respondents believed workouts outside of insolvency would be the most common response, with 40% expecting a mix of refinancing, debt extensions and additional equity support.

How will M&A transactions related to distressed assets trend over the next 12 months?



73% of respondents believe that M&A transactions relating to distressed assets will increase (either slightly or significantly) over the next 12 months, compared with just 8% who expect a decrease.

KordaMentha

For specific questions or feedback in relation to the survey, please contact one of our team members below.

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REVIEW OF THE INSOLVENT TRADING SAFE HARBOUR

TMA Submissions

1 October 2021

1. Introduction

1.1 Introduction

The Turnaround Management Association of Australia (the **TMA**) welcomes the opportunity to provide submissions in response to the consultation paper *Review of the insolvent trading safe harbour* dated 3 September 2021 (the **Consultation Paper**) issued by The Treasury of the Government of the Commonwealth of Australia (the **Government)**.

1.2 About the TMA

The TMA is the premier professional community dedicated to turnaround management and corporate renewal. TMA is a non-profit association governed by a national board and State and NextGen Committees in Queensland, New South Wales, Victoria and Western Australia.

TMA's local membership (close to 800 members) includes major trading banks, investment banks, private equity firms, hedge funds, finance, law, accounting & management consulting firms, together with chief restructuring officers; principally those who are actively engaged in financial and operational restructuring or provide ancillary professional advice. TMA forms part of a global network of Turnaround Management Associations with some 8,000 members spread through the Americas, Europe, Africa and Australasia.

We thank you for taking the time to read this submission and would be happy to share our knowledge and experience in turnaround, restructure and insolvency advocacy with your office, or any other stakeholder you may nominate, to help ensure better outcomes for businesses.

1.3 Acknowledgement

The TMA and the authors of these submissions acknowledge the assistance and feedback of the various TMA members who have contributed to the discussion of the issues surveyed in these submissions. Any errors or omissions are attributable to the relevant authors.

1.4 Views expressed in these submissions

The views expressed in these submissions represent the views of its authors, but do not necessarily reflect the views of all members of the TMA. In preparing these submissions the authors have sought and considered the views of TMA members, and sought to reflect a considered position that on the key questions best reflects the majority views of the broader TMA membership.

However, as can be expected for a "broad church" such as the TMA, contrary views have been expressed to us on a number of the points made herein.

1.5 Intellectual property

The contents of these submissions remain the intellectual property of the relevant authors and/or the TMA as applicable. These submissions may be reproduced but should not be used or reproduced without attribution to the TMA.

1.6 Disclaimer

The contents of these submissions are for reference purposes only and may not be current as at the date of these submissions. The submissions provide a summary only of the subject matter covered, without the assumption of a duty of care by the TMA, its members or any of the contributing authors. The submissions do not constitute legal advice and should not be relied upon as such.

2. TMA Approach to Consultation Paper

2.1 Approach and Key Findings

TMA made extensive submissions in support of the introduction of the Safe Harbour (**SH**) reforms, the propositions within which are adopted here. The TMA continues to support these reforms which, as discussed below, have been effective in saving enterprises and/or saving the business of those enterprises (thereby saving jobs, preserving social infrastructures in communities and maintaining all the downstream relationships that come of continuing businesses). TMA understands that other associations and key stakeholders will also lodge submissions in support of the SH reforms.

We will not re-argue those propositions in this paper. Neither will we resubmit our reasoning that restructuring reform needs to be holistic in nature.[1] Instead, this paper seeks to provide qualitative information around the relative success of SH reform to facilitate various restructurings and to use the qualitative responses of our members to answer the review questions outlined below. We suggest some improvements and further reform in the following parts of this paper, though again encourage the legislature to undertake a holistic approach to corporate revival of ailing enterprises.

2.2 Methodology

We have drawn the conclusions that follow from fifty five [55] case studies based on lived experiences of a sample selection of twenty [20] TMA stakeholders.[2] Other TMA stakeholders and members will have additional

[1] Refer -TMA Submission dated 17 September 2021 "Helping Companies Restructure By Improving Schemes of Arrangement" (**TMA Schemes Submission**).

[2] Allegro Funds, MA Financial Group (formerly Moelis), Houlihan Lokey, Faraday Associates, Vantage Capital, Wexted Advisors, R-Cubed, Carl Gunther, Clayton Utz, Herbert Smith Freehills, Ashurst, Corrs Chambers Westgarth, Hamilton Locke, Baker McKenzie, FTI, McGrathNicol, KordaMentha, Deloitte and KPMG. The authors did not have sufficient time to survey all member firms, with apologies to those not here featured.

reflections from which further conclusions can be drawn. Indeed, a number of the contributors to the below case studies will be submitting their own submissions in favour of the maintenance of SH.

Our studies span ten [10] sectors.[3] For analytical purposes, we have included examples of enterprises that used SH and those that did not. Some of our sample companies undertook operational turnaround as well as deploying capital restructuring strategies, some also implementing some form of workout arrangement.[4] A limited number of the enterprises under examination ended up in liquidation, though our contributors consider that **every** one of the [48] case examples with an acknowledged SH ended up achieving *better outcomes* than expected via an unplanned insolvency process.

Our methodology derives from advisors to SH situations.

The data we present obviously biases towards situations in which directors have understood the need, or been encouraged by influencing stakeholders (typically senior creditors) to speak with advisors. The data nevertheless remains relevant given most boards facing distressed trading circumstances will engage with lawyers, accountants, financial, business and capital advisors. These are the intermediaries who commonly recommend engagement of AQEs (appropriately qualified entities).

Intermediaries may not have the specialist experience to provide AQE advice in distressed circumstances, but instead act as influencing agent in ensuring proper skillsets are brought before the board to assess the cause of the special situation facing the company, to test systems, rebuild proper forward sensitivity models, reconnect with stakeholders (internal and external), use trusted relationships with capital, assist in the preparation of turnaround plans, monitor and report against these and modify as necessary and support the panoply of work that goes into successfully saving distressed enterprises. That is the role of the AQE team, often a team formed of financial, capital, legal and operational advisory capabilities, with a depth of experience in dealing with distressed entities (formal and informal).

2.3 Observations[5]

In almost all examples, the pre-SH business survived, and continues to trade in mostly intact form. More than 85% of the examples resolved

[3] Refer Table 1 in the Appendix.

[4] Although these labels are used for convenience of description rather than as absolute definitions, we here use *turnaround* to reference operational, brand, market positioning and other business improvement strategies. We use *restructuring* to essentially cover capital initiatives, ranging from debt for equity swaps, financial resets, covenant re-writes, capital raising, refinancing, new issues of debt instruments, merger + acquisition and non-core asset divestments (amongst others). We use *workouts* to encompass the resolution of shareholder disputes, contractual resets and non-financial changes or repositioning of the enterprise in the market.

[5] Each of our 55 case examples are summarised in Appendix A to this submission. The Appendix sets up a number of representations of this information in successive tables.

distressed conditions (some dire) by way of informal bilateral and multilateral contractual re-arrangements with creditors and other stakeholders. Those arrangements typically required further capital injections to be made into the business. The remaining 15% of outcomes required the utilisation of formal (mostly voluntary administration (**VA**), some receivership) processes to access statutory moratoriums and/or compositions. Only two [2] of the fifty five [55] cases report as sole liquidations (two further examples used liquidation as an end mechanism after completion of the SH engagement). Notably, **every** example, including the liquidation outcomes, report as achieving *better outcomes* than would have been expected in alternative, unplanned, processes.

Our contributors consider that about half of the informal arrangements the subject of our worked examples would have required unplanned or limited planned formal processes if SH had not been in place (and we can draw from pre-SH experiences to say that some enterprises that underwent formal processes may well have avoided such processes (if SH had been in place at the relevant time).[6]

Put another way, if not for SH, our contributors consider that by the time of their engagement, more than [20] of the examples that ended up as informally negotiated business continuation success stories would have had no option but to proceed through a VA process (which, may well have ended up with similar outcomes but with a higher agency cost associated with the process in the form of external administration costs).

In relation to those that underwent formal procedures,[7] feedback suggests that the *better outcome* success of the process came from pre-planning steps preceding appointments.[8]

We draw these conclusions from the case examples:

- SH is effective in providing time and space for directors pre-planning successful turnaround, restructuring and workout strategies;
- SH can run for a short period, though typically extends over many months (the larger enterprises requiring perhaps in excess of 12 month periods, with many iterations of the plan);
- successful enterprise saving initiatives highly bias, in our sample set, to informal rather than formal processes. The favoured formal process is VA, sometimes supported by receivership;

[6] *Henry Walker Eltin* is a commonly cited example. There are many others though this is not the place to publicly identify them.
[7] *Speedcast* being one - the need to impose moratoriums leading to a very expensive, and successful, Chapter 11 exercise.
[8] Preparing for necessary court orders, ensuring funding lines were available to maintain the business during post-appointment turnaround and restructure events, ensuring key stakeholders had negotiated restructuring support agreements and were satisfied with valuation and other information exchanges etc.

- some advisors seem (respectfully, wrongly) to narrowly construe the pre-requisites for entry into SH and some boards appear to take the view (albeit we think incorrectly), that SH is a disclosable event (either under listing rules or under financing covenants) - thus, some [3] examples indicate situations in which the enterprise directors qualified for SH, yet "did not enter" SH;

- pleasingly, contributors uniformly consider that enterprises the subject of these case studies (and perhaps more broadly from anecdotal experience) are signing off on SH as a "whole of business" strategy rather than, for example, as a 'tick a box' or 'checklist' approach as was feared;

- while the risk of director liability in a failing company is perhaps more perceived than real, it is, nonetheless, a powerful incentive in the minds of professional boards - directors without 'skin in the game' - as to whether to expose themselves to risk of losing good reputations in trading on distressed enterprises. While boards do not necessarily immediately appoint voluntary administrators when in a crisis, robust and confident actions become harder to justify in the face of fiduciary risk - see, generally, *Bell* and more recently the long cost and stress occasioned to *Arrium* directors for decisions taken by that company prior to VA. SH is a good step towards maintaining the engagement of this form of non-executive director in distressed conditions, though, as [3] case examples show, is still not a complete answer to concerns from members of this independent governing class;

- a more common problem is the one facing the investor nominee director - because of the structure of funds, the General Partner managing the fund cannot expose themselves to litigation risk when investing into a distressed situation (which, because of the potential reward profile, is precisely the sort of investment funds should be investing into). This is perhaps exacerbated by uncertainties and insolvency carve outs within Director & Officer insurance policies. In one case example, it was the litigation risk associated with a distressed company that led to a formal appointment over a riskier informal workout. We suggest some legislative adjustments below to make SH an objective rather than subjective test.

We do offer this rider - the past 18 months have been unprecedented, not simply in terms of the public sector response to the pandemic but more generally in terms of market liquidity. That liquidity will not be in the market forever, so some of the *better outcomes* achieved outside a formal process will probably require statutory moratorium support in the future.[9]

[9] In relation to which see the TMA's detailed submissions in the TMA Schemes Submission.

This suggests more VAs, or schemes, to execute strategies developed under SH protection in the lead up to such appointments.

Expressed differently, SH does not abrogate VAs; it provides the time support needed by the directors to plan a turnaround strategy which may well be executed inside or outside a formal process. The market, more specifically, liquidity in the market and the support of a company's trades (and other creditors) to suspend action, dictates whether the plan implements informally or under the protection of a statutory moratorium.

In conclusion, the TMA sincerely believes Safe Harbour is working, the attached case examples pleasingly establishing a number of Safe Harbour led success stories.

3. Responses to Treasury's Questions

	QUESTION	TMA RESPONSE
1.	Are the safe harbour provisions working effectively?	Yes, mostly, in these respects: • Awareness - directors in companies facing liquidity pressures are taking advice on eligibility criteria for SH, then, as a formal SH or as part of the ordinary business planning of the company, ensuring employee entitlements are met and financial and tax records are maintained (and fraud risk reduced) as plans adapt to changing circumstances. • Engagement with experience - the case mix we present tends to suggest that AQEs are being engaged across a range of both small and medium sized enterprises (SME) and large entities experiencing distress. • Outcomes - the case studies speak for themselves. Every outcome reported in this dataset was better than the alternative (unplanned VA or other formal insolvency process). Planning, once more, is key to setting up successful outcomes. Obviously, other reforms might be made to enabling processes (eg: schemes) and attracting new capital into the restructuring (a discussion for another day). We suggest some potential reform at [A13] below for consideration.
2.	What impact has the availability of the safe harbour had on the conduct of directors?	Positive - in [52] of the case studies, directors actively engaged with SH concepts,[10] to save companies, utilising a combination of turnaround, restructuring and workout steps to rescue the ailing company.

[10] [48] formally and [4] according to the facts even if no formal resolution was passed.

	QUESTION	TMA RESPONSE
		Of the remaining case examples, [2] were assessed as not being insolvent or likely to become insolvent, so the steps involved in the (solvent) turnaround strategy formed part of the usual business judgments of the board. Pleasingly, by considering SH principles, the boards involved (a) showed an active understanding of the broader stakeholder interests when undertaking a turnaround; (b) took advice from an AQE (or experienced person in the s187 *Corporations Act 2001* (Cth) (**Corporations Act**) context); and (c) ensured business and financial records, tax filings and satisfaction of outstanding employee entitlements lay at the forefront of these business judgments. The [1] "unsuccessful" SH appears to have been a result of a creditor determining to act in a 'zero-sum' manner (and, so it would seem, gaining a lesser return on its debt than would have been the case on the alternative restructuring plan). This situation provides a useful case lesson for senior debt holders seeking to act in a unilateral manner.
3.	What impact has the availability of the safe harbour had on the interests of creditors and employees?	Each of the case examples, except [2], involved employees receiving full satisfaction of entitlements (it is unclear what return would have been achieved in a non-SH led restructuring). In a number of the examples, senior debt took losses (or accepted equity in lieu of debt) for the benefit of achieving full returns to employees and, in a number of these examples, full return to unsecured creditors. TMA observes that both VA and informal arrangements are progressively seeing the interests of smaller unsecured creditors (and, almost always, employees) favoured in continuing business outcomes. This may partially be driven by the de-leveraging benefits senior creditors can achieve from remaining exposed to a post-restructured trading entity, but also, perhaps, to a recognition that small trade creditors should not suffer value destruction in trade-on situations. While this recognition is not unique to SH situations, by encouraging boards to early engagement with AQEs to assess the cause of distress in an entity and to develop turnaround plans, there is more prospect of the AQE identifying trade-on outcomes earlier in the life cycle of the enterprise. Contrast this situation with the one that usually faces a voluntary administrator appointed by directors once they have run out of other options (stretching of creditors; divestment of assets; reducing capex and opex to the point that plant and systems become obsolete or inefficient; destruction of trust

	QUESTION	TMA RESPONSE
		when information is not shared or is communicated in a misleading way; loss of key workforce members etc). By this time, the voluntary administrator has fewer levers available to recreate a sustainable business. What SH does is enable AQEs to come into the piece earlier, to redirect the focus of directors, to recreate trusted external stakeholder relationships, tap available capital, plan-up improvements in the business, restore belief in the brand and strategy (including within the workforce) and bolster the confidence of directors to work with management on a plan and its various iterations.
4.	How has the safe harbour impacted on, or interacted with, the underlying prohibition on insolvent trading?	Positively. In the referenced examples, SH was the enabler for directors to commit to turnaround plans, without which a number of these saving exercises would not have completed (either because the project would not have begun or because the directors would not have been bold enough to stay with the plan to completion). Some of these plans have run for extended periods, many more than 12 months. It is difficult to keep directors 'without skin in the game' focused on the time and stress commitment of a plan over an extended period.
5.	What was your experience with the COVID-19 insolvent trading moratorium, and has that impacted your view or experience of the safe harbour provisions?	According to the case examples, only [19] cases utilising SH over the past 18 months derived from COVID-19 induced trading circumstances. The remainder of cases utilised SH to deal with the usual range of other problems that might otherwise cripple a business (typically, over-leverage, market changes, poor financial management, antiquated processes and other operational under-performance, brand and strategy refresh needs). On COVID-19 impacted businesses, one of the authors to this paper provides comment this way - the moratorium removed immediate failure fear from half a dozen engagements. That relief was replaced, in short order, by a sense of almost invulnerability that needed to be tempered by keeping the relevant entity to the relevant plan. Moderation came in the form of focusing on the better outcome test in s588GA of the Corporations Act, which remained (without a better outcome, it is difficult to see how the directors could continue to discharge the broader statutory duties in ss180 - 184 of the Corporations Act). As with so much else, this was an education process around the need for directors to make decisions (including non-decisions that amount to a course of conduct) on enterprise-first grounds.

	QUESTION	TMA RESPONSE
6.	Are you aware of any instances where safe harbour has been misused?	No.
7.	Are the pre-conditions to accessing safe harbour appropriate?	Yes, though as per A13 below, TMA suggests a slight edit to the requirements to make clear that entry into SH is not a subjective decision of directors but an objective conclusion to be drawn from the circumstances. This requires an examination of the full factual matrix, one such part being the subjective mind of the directors. Otherwise, the [48] cases in which SH was enlivened in fact, but not as a substantive determination, may well become normative.[11] Some of our contributors have remarked on s588GA(4) disqualifications (tax compliance and satisfaction of employee entitlements). Some advisors have taken unduly technical views as concerns satisfaction of the pre-requisites,[12] while the strict nature of the disqualification can capture even inadvertent non-compliance.[13] Plainly, this is not the intent of the SH defence. The defence should perhaps be tightened up to make clear that by inserting in s588(4)(b)(i) and (ii) the words: *is not capable of relief under section 1318(1) of the Corporations Act* The addition enables the defence to operate where a director has acted honestly and **could** bring an application under that provision (whether or not the application is made - ie. the SH defence remains available for directors acting honestly

[11] We were told that in some situations (not the subject of the case examples) the requirement to have met employee entitlements precludes entry of many entities into SH. As none of the case examples faced this problem, we cannot really say if this represents an emerging problem (and note the complexity of the issue given superannuation entitlements rather than payroll is the focus of the reference).

[12] Contributors have noted that some (probably non-qualified advisors) have suggested the defence is no longer available if, **during** any payroll period cash balances fall below employee entitlement obligations falling due on the next payroll payment date. This may be the case if the company incurs a debt when it has run out of options to replenish cash funds, but not necessarily otherwise. Another contributor advised in a situation in which a company was and could continue to meet employee entitlements as these fell due (including sick leave, holiday land other leave as these were taken) but was not in a position to meet retrenchment costs of the posited alternative liquidation; according to our contributor, it took some time for the board to understand that the relevant employee entitlements required to be met were those "as they fell due" not those that might arise in a liquidation (it seems some of the directors had taken legal advice from someone who was not "AQE"). Usually, AQEs with proper experience can resolve these sorts of definitional issues.

[13] Posit this example - employee entitlements are often payable under a myriad of industrial instruments. In recent years, audit compliance has identified a number of non-compliant payments by a number of Australia's largest employers. While cases of intentional underpayment may well arise in ailing companies, it is not the intent of SH for the defence to disqualify because of an *inadvertent* failure of systems or clerical, administrative or oversight errors inside an organisation. A similar observation applies in relation to enterprises operating across complex tax environments where compliance responsibility often sits with junior staff. Systems are meant to spot errors, though no system is infallible, nor are people. Mistakes happen. These should not operate as disqualifications.

	QUESTION	TMA RESPONSE
		irrespective of whether or not a finding is made concerning negligence default or other relevant s1318 breach). At all times, the legislation should, it is respectfully submitted be consistent with duties obligations and expectations under Chapter 2D of the Corporations Act.
8.	Does the law provide sufficient certainty to enable its effective use?	Yes - all circumstances differ and many decisions are made according to the scale of the venture (the solvency decisions of directors within a conglomerate with derivative and complex contractual obligations will be very different to the considerations of a smaller retailer with landlord problems associated with temporary lockdowns).[14]
9.	Is clarification required around the role of advisers, including who qualifies as advisers, and what is required of them?	No - all situations differ. AQEs with insolvency experience were involved in at least [42] of the examples given. Other times, the AQE comprised one or more of turnaround professionals, lawyers, capital market advisors or, occasionally, skillsets within the company involved. TMA encourages ASIC to monitor the broader market to see if non-qualified parties are misleading directors into improper phoenix situations. TMA has not seen this happen and suspects it may be more prevalent at the micro enterprise end of the market. This will probably not become visible until after the run off of COVID-subsidies. Directors must be left to choose skillsets that address their particular circumstances. Many times, they will come to rely on an AQE with insolvency or restructuring experience, other times, they will not. Advisors will work out their roles with appointors - the company will have its own advisors, who will differ from the directors' advisors (collectively or singularly). The parties should be left to define the scope of each engagement according to their specific needs.
10.	Is there sufficient awareness of the safe harbour, including among small and medium enterprises?	Difficult to say and probably a question better answered by AICD and industry bodies representing users. From the perspective of the TMA and based on the worked case examples, SH does seem to have imprinted itself as a concept in the minds of directors across a spectrum of SMEs as well as large and mega companies.
11.	In relation to potential qualified advisors, what barriers or conflicts (if any) limit your engagement with	The question covers a gamut of enterprises - directors who are overly entrepreneurial are often reluctant to take advice early. Those without personal exposure to the success or failure of an enterprise and who are overly mindful of personal reputation (or in the case of fund nominee directors, the

[14] Strictly, the AQE provides "advice" rather than a guarantee as to the satisfaction of SH requirements. It is for the directors to be satisfied as to these matters, based on that advice.

QUESTION	TMA RESPONSE
companies seeking safe harbour advice?	enabling instrument under which investor money is deployed into a situation) can take too much advice and be overly conservative. Thankfully, the case examples provide enough of a database from which to observe that the greater body of enterprises are governed by directors with a willingness to take advice, an intelligence to structure successful turnaround plans and the grit to stay with the plan through to success (or wisdom to reset plans as needed). In due course, stories of successful turnarounds will sufficiently permeate the collective thinking of those who sit on boards as to encourage the engagement of AQEs early in the distress cycle of the enterprise (or even war planning the possibility of business downturn). There also appear to be three emerging practices likely to create structural barriers against SH in due course: • At least [3] examples report directors unwilling to formally resolve on SH because of reporting concerns (either to listed entities or to lenders pursuant to contracts) - the first is, essentially, an education problem in that some directors, possibly also advisors, are mischaracterising SH as some formal process requiring a formal resolution to "enter" SH. As the law reads, SH is or is not engaged by satisfaction of the criteria, not by whether or not the directors understand that the relevant defence has activated. As a result, reporting obligations turn less on the "entry" of SH and more on the materiality of information in the market under the usual continuous disclosure obligations and whether that information needs to be corrected (for example around changes to a disclosed business plan, market guidance or some other similar market information). The suggestion in A13 below may help alleviate this concern. • Further to A13 below, a SH based on a defence to s588G sits awkwardly in relation to broader directorial duties within Ch 2D of the Corporations Act. Anecdotally, fund nominee directors and some professional directors (without personal stake in the companies they represent) find it hard to justify exposing reputations and ultimate appointors to claims that may or may not be defensible under s588GA. In this regard, directors are required to make decisions ex-ante yet those decisions are examined on a post-hoc basis. The defence within s588GA, as used by TMA members, sensibly

QUESTION	TMA RESPONSE
	encourages directors to maintain contemporaneous records of decision making and available information on which to draw inspiration for decisions. Nonetheless, a defence based exception to insolvent trading risk is not as strong as an extension of broader "business judgment" rule, which shifts the onus from the directors justifying a position to an external authority establishing the decision making fell below community expectations around the proper discharge of duties. As has been raised by the TMA previously, it might be timely to explore with the community whether insolvent trading rules ought be replaced with wrongful trading rules, which focus on the propriety of the decision according to community expectations. The TMA would welcome the opportunity to participate in any relevant holistic reform agenda. • Feedback from our contributors suggested an emerging practice of including as review events within credit instruments provisions to the effect that SH entry shall trigger creditor enforcement or other rights - this is neither helpful nor particularly measurable if no formal resolution is passed to enter SH. It should be enough that a company is under an obligation to its credit counterparties to report solvency or liquidity problems. There is no cause to require directors to disclose whether or not the SH has been activated (indeed, having regard to our previous comments, it is not always possible for directors to even be aware of such matters). While the legislature is (understandably) generally reluctant to interfere in free contracting between parties, it would not be difficult to expand ipso facto restrictions to include circumstances giving rise to statutory defences. That at least removes the chance of SH becoming a termination trigger point. It is then left to the parties to decide if the circumstances that give rise to SH protection (notably insolvency in its actual or apprehended form) should trigger review or reporting events. Presumably they will, which seems to be a sensible way for financiers to understand the situation they may well be asked to support at some point in time. Banks and other senior creditors should continue, as intermediaries, to encourage distressed entities to engage AQEs to properly utilise SH as part of turnaround planning.

	QUESTION	TMA RESPONSE
12.	Are there any other accessibility issues impacting its use?	See the edits proposed in A13 below.
13.	Are there any improvements or qualifications you would like to see made to the safe harbour provisions and/or the underlying prohibition on insolvent trading?	Yes, s588GA(1)(a) of the Corporations Act could be amended to read: *at a particular time after ~~the person starts to suspect~~ the company may become or be insolvent, the person starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company; and* This edit removes the subjective element of an entry into SH and reintroduces the objective nature of the defence (which is also consistent with s588GA). This makes it clear that qualification for SH is not something the board need to specifically adopt by resolution but is a circumstance that exists for addressing by way of the turnaround plan with the help of an AQE. And, more generally - • Processes - there are five different regimes in Australia for dealing with distressed companies: schemes; VA and the DOCA or Creditors' Trust; various forms of liquidation; small business restructuring and SH protected non-formal arrangements). Moratoriums, qualification, composition, trading (including personal liability) and distribution rules between each differ, which adds confusion for users (directors, creditors) - TMA would like to see a holistic investigation of these systems as part of a new Harmer-like review. • Incentives - there is some literature to suggest that creditor favoured systems restrict capital into restructurings and discourage the risk taking associated with each of the [50] worked examples within this submission of corporate rescues. While these matters need to be considered as part of the holistic reform investigation mentioned above, TMA would encourage Treasury to explore models associated with the priming of rescue financing, better cross-group composition rules (e.g. using schemes of arrangement), clearer moratorium triggers, potential relief from conflict rules when dealing with pre-planning around formal appointments, some mirroring between the cleansing requirements under international (esp. New York) instruments and those written under UK or Australian law instruments,

QUESTION	TMA RESPONSE
	addressing issues between service agents associated with international financing instruments and addressing questions of value in dealing with s444GA applications. • 'Insolvent trading' might be replaced with 'wrongful trading' to ensure that director misconduct or activity inconsistent with serving the best interests of the enterprise is the new focus of post liquidation recovery action. This reform would also bring consistency to the Australian condition as compared with the United Kingdom and Singapore. It would make the SH redundant because directors' actions would then come to be assessed under propriety rather than presumption rules.

Appendices

Appendix A - Series of population breakdowns, represented in graphic form:

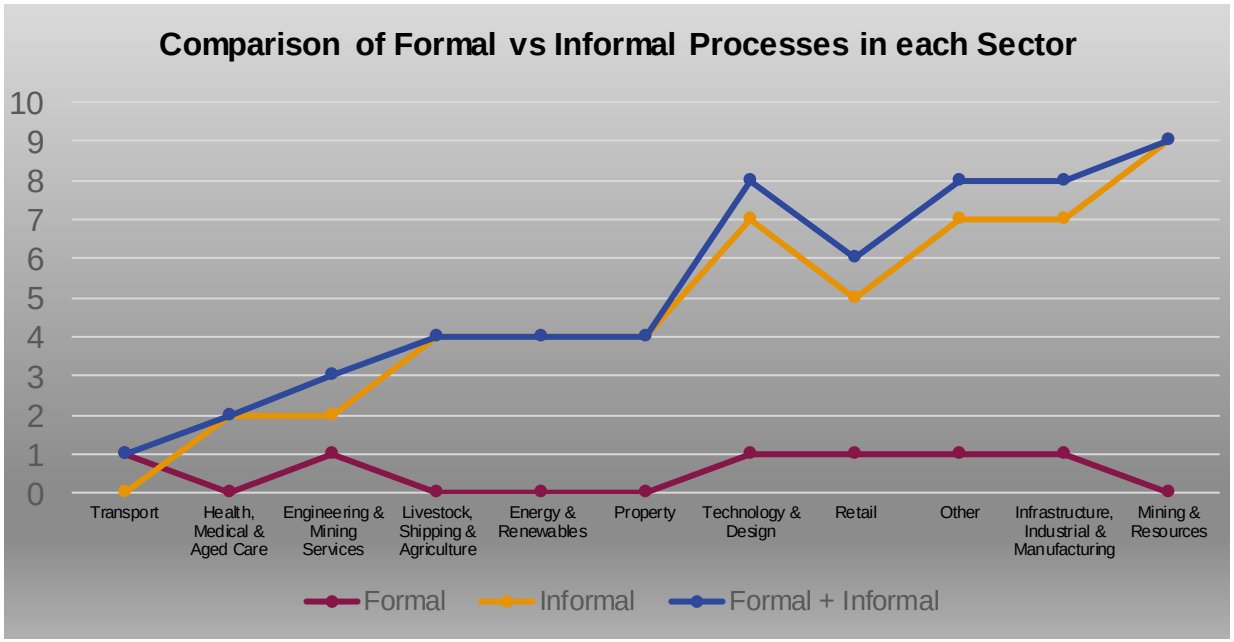
- Graph 1 - Sector Case Example Comparison
- Graph 2 - Comparison of Formal vs Informal Processes in each Sector
- Graph 3 - Continuing Business vs Liquidation Outcome in each Sector

Appendix B - Detailed Case Example Analysis

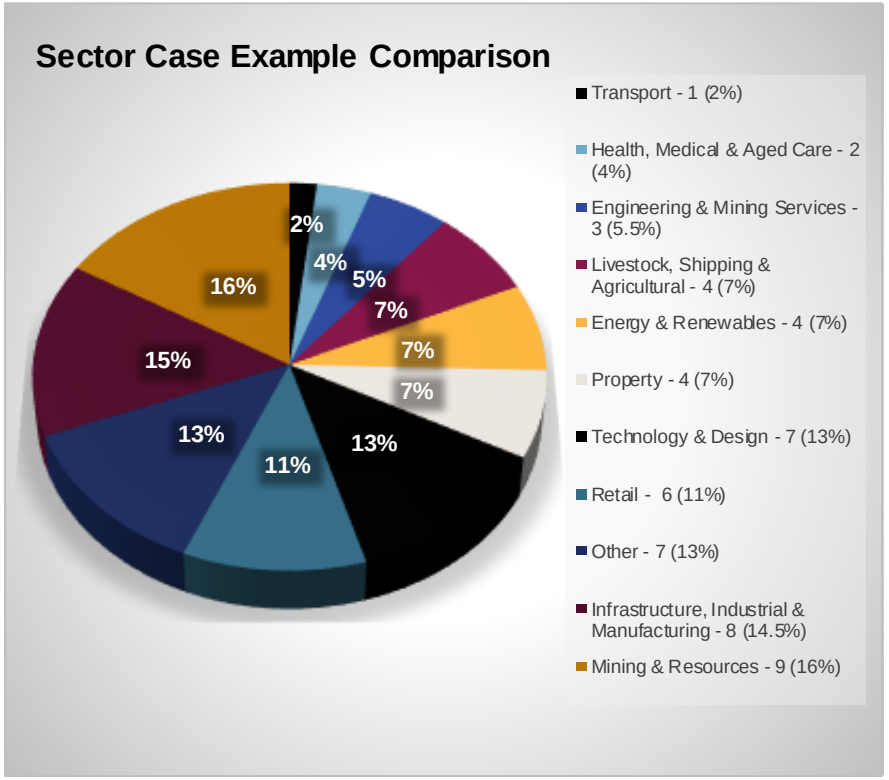
Appendix C - Series of population breakdowns, represented in graphic form:

- Graph 1 - High Correlation between Informal Arrangements and Continuing Business Outcomes
- Graph 2 - Relationship between enterprise obtaining AQE Advice and surviving as a Continuing Business

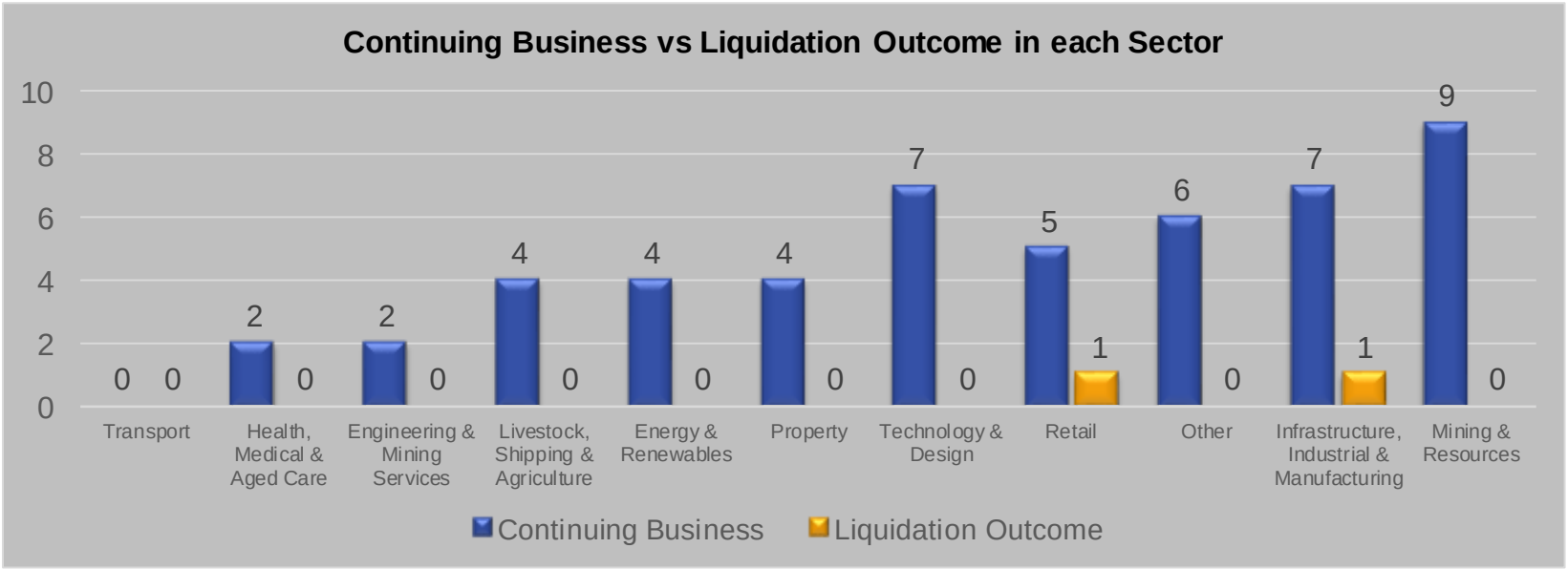
Appendix A



Graph 2



Graph 1



Graph 3

Note: None of the Liquidation Outcome scenarios resulted in creditors being paid in full.

Appendix B - Detailed Case Example Analysis

Sector	Summary/Outline	Was a SH used?	Case examples involving AQE	Scale of Enterprise[1]	Formal or informal process[2]	Covid caused distress	Continuing business or Liquidation outcome	Duration of Safe Harbour	Methods used to restore liquidity or solvency and comments on better (or worse) outcomes
Industrial etc.	The Australian subsidiary of a global mining conglomerate was impacted by delays and cost overruns on a project to complete a major industrial processing plan. Anticipated cashflow from offtakers to the project could not be accessed (because the plant had not achieved practical completion and so could not complete commissioning or ramp up). At the same time, the offshore parent experienced cashflow problems in its global business. Liquidity pressure created structural risks around its leasing and other operating obligations, exacerbated as international banks locked down on financial support from the global parent and sought additional security support. Cashflow projections identified near-term dates for cash depletion, which would have meant a stand-down of a considerable workforce and prevented commissioning of	Yes (multiple iterations)	Yes (multiple firms providing different skillsets)	Mega	Informal	No	Continuing	12+ months	- Improved liquidity from offtakers and deferred delivery obligations - negotiated new monthly cash transfers with offshore parent matched to 4 weekly and adjustable 13 weekly cashflows (constructed by CFO, regularly tested and improved by AQE) - SH requirements tested (esp around the large workforce) on a weekly or multi-weekly basis - renegotiated payment terms (extensions) with existing creditors and moved to a cash on delivery system with new supplies - moved into claim/cross-claim dispute with EPC contractor - tested parent financing capacity and adjusted plan multiple times to fit changed raising initiatives - investigated special situations financing

[1] Data sets are given in ranges to protect transaction identity. Post restructuring EVs are broken into these brackets $10m - $50m, $50m - $10m, $100m - $500m and $500m+, with respective labels: *Small, Medium, Large, Mega.*

[2] For example - Voluntary Administration (and/or Deed of Company Arrangement/Creditors Trust Deed), Receivership, Chapter 11 (US Bankruptcy Act), Scheme of Arrangement.

	the plant (and ramp up towards cashflow independence from the global parent). Cash support from the parent was expected to remain problematic until its offshore syndicated lenders resolved to continue support for the group entities (which was expected to, and did, involve almost 12 months of negotiation). The directors wished to undertake a series of turnaround (operational), workouts (lease and offtaker renegotiations) and capital restructure (re-classifying debts by agreeing arrangements with trade creditors, financiers and parent entities). The board ensured SH qualifications were satisfied, also engaging financial and legal advisors to support conclusions drawn by directors around operational improvement, cashflow and capital management planning. After a lengthy period, the parent entity was able to initiate a large M+A transaction that led to the injection of sufficient cash to resolve mid term liquidity constraints within the Australian entities.								- undertook a mega (completed) partial cornerstone investor transaction which led to new liquidity into the companies - progressing to system ramp up and production to gain cashflow control from Australian operations The company continues to trade and move the plant through commissioning to ramp up. The plant promise to be one of world's largest processing operation for this form of product.
Mining	Cashflow came under pressure because of payment defaults by offtakers, complicated JV structures (and defaults by JVP), commodity pricing deflation	Yes	Yes (multiple firms providing different skillsets)	Large	Informal	No	Continuing	6+ months	SH enabled the directors to adjust opex and defer capex, while continuing negotiations with both the defaulting offtaker (since paid) and JVP (since resolved).

	and some operational problems.								The company resolved its issues by way of an operational turnaround rather than a capital led restructuring outcome. Its directors needed SH to provide time to support the strategies developed with the AQE.
Financial Services - other	ASX Business survival risk was triggered by default triggers claimed by a senior lender seeking to execute on a loan for own strategy. The company was forced to seek funding from the special situations market under threat of enforcement action by the lender. At the same time, it was forced to make significant operational changes to its business model to counter Covid caused changes in its forward book strategies.	Yes	Yes (multiple firms providing different skillsets)	Medium	Informal	Partially	Continuing	4 months	SH provided the board with four main tools (1) weekly analysis of its financial position across a complex structured finance group (2) information from which to make business efficiency changes in the business to improve operational performance and to reduce cash burn (3) time to negotiate with special situations lenders without deal-fail risk (enabling the directors to be price makers rather than takers in the negotiations) (4) space to consider alternate strategies if the refinancing was unsuccessful (to avoid an unplanned fire-sale via formal process). Refinancing was successful. The company has exited the SH and is growing.
Energy and Renewables	ASX business operating offshore assets was impacted by Covid crash in Brent-crude pricing of oil (its principal sales), looming capex obligations under farm-in arrangements, safety concerns over staffing movement constraints on its workforce and some legacy disputes between shareholders and members of the board. Some of these issues contributed to unexpected defaults under NTA and cash support	Yes	Yes	Medium	Informal	Yes	Continuing	6 months	Board imposed weekly meeting reporting between the AQE and management and tested management by quadrant reporting across a range of operational, capital and contractual workout plans. Each of the plans were adjusted on a fortnightly, or as required, basis during the SH period. The company successfully exited SH, repaired its balance sheet, improved relations with shareholders and maintains an open relationship with its lenders.

	covenants in favour of the business lender. The directors formed plans to address shareholder disputes via management changes, terms of capital underwriting agreements and by negotiating contingent resets with the business lender (contingent on capital raising initiatives proceeding, which they did). The company then engaged in long running renegotiations with farm in partners to long-date capex obligations. Each of these initiatives were negotiated via information sharing with stakeholders (subject to disclosure rules) and after mapping through 13 month cashflow forecasts with appropriate sensitivity analysis.								
Shipping	Company was impacted by the withdrawal of customer support for its product (high value luxury yachts) during the initial Covid period and by cashflow pressures of its offshore PE owner. The company developed a plan to trade on, build prototype models 'on spec', negotiate funding from a new shareholder and to renegotiate equity with the PE.	Yes	Yes (multiple firms providing different skillsets)	Small	Informal	Yes	Continuing	<3 months	Company was able to attract funding from the new shareholder. The prototype has since sold as customer demand soared shortly after the plan began.

Retail	Long term retailer with heavy exposure to high cost, low profitability shops spread throughout Australia. Its product lines have been suffering losses for some time as it faced global pressures from (inferior) cheaper product and the impact of customer requirements (more internet shopping). Directors developed a mid term plan that required the support of landlords, lenders and a large investment into internet shopping capability as well as a renegotiation of supply chains. The company still needs to refresh brand. These strategies were expected to lead to business survival though, of course, could not be future proofed. The impact of Covid in terms of restricting access to its stores allowed the company to accelerate its non-store strategies and gave the company scope to agree terms with landlords to reduce unnecessary footprint.	Yes	Yes (multiple firms providing different skillsets)	Small	Informal	Yes	Continuing	9 months	SH provided directors the time needed to renegotiate with lenders, suppliers, landlords and to execute on a series of operational improvements and brand refresh strategies. Each of those strategies exposed the company to survival risk (if any of these negotiations had failed). SH provided the directors comfort that they could continue to negotiate the best possible result for the company without concerns around failure risk. The company is no longer in SH and is growing its business.
Mining	Australian subsidiary of a global group, its complex offtake and corporate group funding arrangements (coupled with liquidity pressure within offshore treasury group entities) placed considerable liquidity pressure on the Australian operations. The local management team developed robust cashflow	No	No	Large	Informal	No	Continuing	n/a	Management used the cashflow and sensitivity analysis to maintain liquidity from offshore treasury and maintained trading as a result.

	and sensitivity strategies and some contingency planning to extract sufficient funding from the parent to meet continuing Australian obligations. Strictly not a SH (in the sense that balance sheet solvency was strong and cashflow solvency was manageable, albeit with stretching like strategies more akin to use in restructuring or workout situations), the Australian management mirrored SH approaches in developing the turnaround plan.								
Industrial / Waste Management	An offshore PE owned industrial processing company experienced liquidity pressures as offshore funding was withdrawn (for unknown reasons), plant suffered unexpected and unfinanced breakdowns and the company found itself in dispute with key customers. The Board resolved on a multi-pronged plan to negotiate sale of non-core assets, to attract new asset based financing and to reset customer contracts. These initiatives led to a restart in funding support from the offshore PE fund (which is exploring options to sell down European assets in order to fund and maintain the Australian operations.	Yes	No	Small	Informal	No	Continuing	3 months	SH provided the Australian board structured support to engage in aggressive financial negotiations with its parent entity. This has both unlocked cash support back into Australia, led to a change of strategy at the PE level (to maintain support into Australia) and provided space to renegotiate contractual terms with customers.

Mining	ASX company with overseas assets suffered solvency risk when its principal lender withdrew BFS funding and called for existing loans to be repaid. The lender was reactive to a fall in commodity pricing in 2020. On the back of surging commodity prices, the company has ringbarked the security of the lender (by consent) to a particular asset, successfully raised capital on that asset and is divesting the remainder of its equity in the asset to another party. This enables the ASX company to raise capital (which it has done) on other assets, which it is now developing.	Yes	No	Small	Informal	No	Continuing	9 months	SH provided the Board the time necessary to negotiate arrangements with the lender, capital markets and overseas regulatory bodies to enable the transactions to proceed.
Mining	ASX company with a significantly over-leveraged balance sheet and fading reputation (broken promises) faced sudden, and unexpected collapse in commodity sale price for its product. It late engaged an AQE to try to renegotiate lender, offtaker, logistic supply contracts, each of which were in default and in dispute.	Yes	Yes	Medium	Informal and Formal	No	Yes	2 weeks	The Board took advice and managed to renegotiate arrangements with offtaker and logistics parties, contingent on concluding negotiations with lender (who refused to engage and termed out default notices and appointed receivers). While the SH did not prevent the company proceeding into a formal process, the 2 week period of the plan enabled the board to place its project on 'care + maintenance', to set the terms of renegotiated contracts (subsequently completed by VAs) and to start a process that led to the lender being paid out by a new party. The new party maintained the business and has influenced a new board to bring the project out of care + maintenance.

Property	A property company in potential default of its senior lender obligations and is in something of a gridlock with its funding shareholders (who are in dispute with each other).	Not yet	-	$100m+	Informal	No	Yes	-	The Board are *considering* a SH in order to complete negotiations with the senior lender and to complete an existing capital raising to resolve some of the immediate liquidity problems. The SH will enable the directors to either crystallise the shareholder dispute or move the parties to resolution so as to unlock further capital into the business.
Financial Services - other	Encountered solvency and cashflow problems as it had grown. Business suffered from a high overhead and capex, which drained cash from the business.	Yes	Yes	Large	Informal	No	Continuing		AQE engaged to work with management to refine cash flows and gain stakeholder (main funder) and regulatory support for the restructuring. The business was sold to global interests and meets similar business tests.
Entertainment - other	Licensor dispute costs placed pressure on the company's liquidity	Yes	Yes	Small	Informal	No	Continuing		Shareholder agreed a debt for equity swap. AQE successfully renegotiated arrangements with landlords and the licensor to reduce cashflow depletions. The business used the time afforded to it by the SH to complete these transactions and to recapitalise the business.
Renewable energy	Project experienced considerable delays and was in dispute with the EPC. Its revenues were impacted by regulator imposed curtailment.	Yes	Yes	Large	Informal	No	Continuing	12+ months	Directors sought SH as these issues arose and are successfully executing on a turnaround plan that involves the renegotiation of senior debt, injection of further equity and mediation of the EPC disputes.

Winery - other	Australian family owned business (more than 100 years old) with both national and global markets was asset rich but cash poor.	Yes	Yes	Small	Informal	No			SH continued for a lengthy period as long term payment arrangements with creditors were negotiated, a capital raising attempted and the sale of non-core assets pursued.
Engineering	Australian family owned company servicing the mid market. The unexpected departure of CFO led to underperformance and material forecast cash requirements.	Yes	Yes	Small	Informal	No	No		SH engaged to review and assess whether a higher outcome was possible as against an immediate insolvency. These actions led to a higher return to creditors as the business progressively scaled down and assets were disposed of to pay creditors.
Hospital	Hospital faced deteriorating financial performance, covenant breach and significant new competition impacting cashflow and placing liquidity pressure on the business.	Yes	Yes	Medium	Informal	Partially	Continuing		SH engaged to enable AQE to provide turnaround advice and develop a plan before cash resources were exhausted. The new, competing, hospital has since opened and he turnaround measures have been successfully implemented.
Livestock and Shipping business	Company was in default of multiple covenants under financing agreements due to financial underperformance.	Yes	Yes	Medium	Informal	Partially	Continuing		SH engaged while a turnaround plan was designed and implemented. Plan included negotiation of standstill arrangements, sale and lease back of key assets and potential sale transaction. The turnaround plan has been completed.
Infrastructure	Business was severely impacted by reduction of freight carriage on its infrastructure.	Yes	Yes	Mega	Informal	Yes	Continuing		Turnaround plan assessed various sensitivities around business performance and financial standing, provided options to meet future liquidity requirements and outlined

									restructuring plans. SH provided time to assess the situation, propose and complete a fund raising with principal shareholders.
Mining	Mining operation has sustained losses due to production delays, rising All In Sustaining Costs (AISC) and declining commodity pricing.	Yes	Yes	Medium	Informal	No	Continuing		SH enabled the company to undertake a turnaround plan and undertake a sale of non-core assets and recapitalisation of the remaining enterprise.
Retail	A large 400+ employee company had accumulated heavy losses over several years of poor trading. Directors had developed a dual track turnaround plan to resize the business footprint (negotiating exits with certain landlords), to trade on the business and to secure ongoing finance facilities. The directors were concerned that if the plan did not deliver on promises, the financier would withdraw facilities, forcing the company into an insolvency situation.	Yes	Yes	Large	Informal	Partially	Continuing		SH enabled the AQE to lead negotiations with the financier and landlords, providing information transfers to support the plan proposals. SH gave the directors confidence that a plan-fail would not expose them to personal liability. The plan was successfully delivered.
Engineering	Group companies with almost 200 employees and contractors discovered material impairment provisions on customer contracts (poor financial controls had masked this problem). An immediate remediation program risked company survival.	Yes	Yes	Mega	Informal	No	Continuing		During the SH, the AQE was able to renegotiate arrangements with financiers, assist with capital restructuring repayment arrangements, close down poorly performing business units and focus on improving all aspects of the business from the Board through to construction site performance.

	Directors wished to undertake multi-pronged turnaround and restructuring strategies to stabilise cash while undertaking the remediation program. The directors were concerned that a project-fail would expose them to personal risk.								In addition to restoring its balance sheet, the company has generated positive cash, was able to refocus on (and build a strong book from) customers and to renegotiate arrangements with creditors to match cashflow.
Agribusiness	Company's international business was severely affected by Covid, its supply chain, logistics and domestic sales falling away. As its product was perishable, inventory quickly became obsolete, forcing a series of crisis meetings to deal with sudden solvency risk (for a business that was considered very financially secure before the business disruption). The business developed a robust cashflow forecast, with sensitivities built into different timeframes for the reopening of markets. These timeframes demonstrated that solvency risk was real if reopening was delayed beyond particular points in time. The directors wished to carry on the business rather than taking safer options around appointing a formal process to initiate a sale of the business (which was considered to be value destroying given the nature of the business, which was built on maintaining personal supply contracts).	Yes	Yes	Medium	Informal	No	Continuing	<6 months	SH enabled the company to pivot to a focus on building a new technology infrastructure (online sales) while being ready to initiate physical business lines as soon as restrictions eased in 2020. The company has bounced back into profitability and successfully exited SH with continuing supply contracts, better international freight agreements, a strong online service and better logistics (re-purposed over the lockdown period).

Infrastructure	A large power station with long term low cost offtake obligations came under supply and costs pressure which caused the default of various cross-financing instruments. It needed to engage in debt reset negotiations with its financing syndicate, which took more than 12 months. In the face of defaulting finance instruments, directors were only willing to trade on under the protection of SH having been satisfied that to do so would (probably) lead to better outcomes than an insolvency process. Insolvency provisions within relevant documents would have made it very difficult to implement a restructuring via a formal process without the risk of material economic loss being incurred. Interestingly, a scheme of arrangement with an automatic moratorium may have enabled operational stability while capital structure issues were resolved. Those steps would only have been considered if the lender extensions had not been granted.	Yes (various AQEs)	Yes	Mega	Informal	No	Continuing	12+ months	SH has provided the directors time to negotiate arrangements with both the lender syndicate and the supplier, to negotiate alternate supplies and to open up repricing negotiations with suppliers. The SH will continue for some time. Lenders have extended facilities to provide further time for the company to continue business improvements and to consider other capital options.
Technology	Australian ASX entity filed at implementing an equity recapitalisation as Covid impacted consumer markets. The company experienced a rapid deterioration in end markets (exposed to tourism and oil & gas), with consequent crisis liquidity events. The company was	Yes (various AQEs)	Yes	Large	Informal + Formal	Yes	Continuing	6+ months	The ASX entity was able to remain operating under its board by utilising SH as its subsidiary underwent an international process. SH provided operational stability for certain foreign entities and protected supply chains. The head entity continues to trade

	faced with pursuing an Australian restructuring process or an international process (with attractions around new funding, automatic moratoriums and stays on ipso facto like triggers included in contracts preceding Australian reforms around such triggers).								while certain subsidiaries were the subject of a DOCA process.
Retail	Invested into a collection of retail businesses. While plans were developed to renegotiate footprints with out-of-the-money landlords, renegotiate supply chain arrangements and re-launch to customers, doing so came with a litigation risk that was unpalatable to the investor (as compared with a formal process).	Yes	Yes	Large	Formal	Yes	No	<1 month	The SH plan developed by an AQE was considered and the SH was continued over the testing period. After testing, the plan was assessed as carrying an unacceptable failure risk, hence the board could not be satisfied the 'better outcomes' test would be satisfied.
Resources	PE owned business faced a rapid decline matching the fall in the global price of exported product. The forward book became critical as the PE withdrew funding support. With solvency a large concern, directors (without 'skin in the game') were faced with a 'close or continue' decision. The Board wished to develop a turnaround plan and gained confidence this was the 'better outcome' once they had regard to the TMAA Best Practice Guideline around Safe Harbours.	Yes	Yes	Medium	Informal	Yes	Continuing		Having the confidence to build a turnaround plan with the assistance of the AQE, the Board were able to re-engage funding support from the PE. This funding support led to strong investment into growth of the front book. The strategies for growing new orders has been successful, the company now trading strongly, with increased profitability.

Industrial	Board has faced difficult trading conditions and has engaged AQEs to assist develop turnaround plans. These are the features assessed by the Board: - explicit understanding of the threshold for a better outcome - testing of liquidity at each board meeting - testing whether each initiative has evidence of progress at each board meeting - assessing solvency and risks or sensitivities around solvency -attracting solutions that might provide better outcomes -providing information to lenders around those outcomes, with sufficient time given to the lenders to assess the proposals	Yes	Yes	Mega	Informal	No	Continuing		This SH is ongoing.
Industrial	PE owned and financed business was underperforming in parts of Australia die to unprofitable contracts with statutory authorities (overseas contracts were profitable). The PE fund loans were subordinated in the security	Yes		Medium	Formal	No	No		SH enabled the directors to test the market for sale of the (profitable) overseas business. Funds were repatriated to Australia to payout senior lenders, and to finance a VA process. The VA renegotiated contracts with government or

	stack to senior loans provided by Australian trading banks. Without alternate funding options, the directors developed a liquidation plan while under SH, which they then executed via an insolvency (VA) process.								liquidated business units where renegotiation was impossible. Employees received better outcomes than would have been the case in an unplanned insolvency process (and banks were repaid from proceeds realised on a non-distressed sale of the overseas assets).
Mining Services	Australian Joint Venture company owned and financed by two global petrochemical conglomerates suffered cashflow problems. Those problems stemmed from exposure to a large, unprofitable, contract (projects costs escalated because of market conditions without commensurate revenue adjustments). The directors attempted to renegotiate the contract, explored refinancing and recapitalisation plans and examined sale options (M+A) under the protection of SH.	Yes	No	Small	Formal	No	No		Ultimately the directors attempts to achieve better outcomes for creditors were unsuccessful (because the principal on the unprofitable contract refused to renegotiate revenue terms), leading to the appointment of VAs (and eventual liquidation of the JV company). The efforts of the directors did, however, lead to the creation of a database of interested buyers, utilised by the VA in sale of the business and assets (an unplanned VA would have led to value erosion in the assets, which would otherwise have been sold on a fire-sale basis).
Property	A former shipbuilding company, now holder of valuable (but non-income producing) industrial land. On a cashflow basis the company was insolvent; yet on a balance sheet basis, held assets well exceeding the obligations payable to senior lenders, redundancies and other debts.	Yes	No	Large	Informal	No	No	6 months	Directors were able to secure PIK funding to satisfy the banks, fund the litigation (which was successful) and fund a lengthy process to remediate, re-zone and sell the underlying land. These efforts realised $100m, which sum may not have been possible if Receivers had sold the land on an 'as is' and un-remediated basis.

	Directors formed the view that the shipping business should close, underlying industrial land should be remediated and re-zoned and then sold to satisfy the various debt obligations and to remit surplus to shareholders. Directors also wished to pursue litigation which needed to be financed on a monthly basis. Lenders were threatening to appoint receivers.								
Insurance - other	ASX Company with 100 employees impacted by regulatory changes, experiencing a significant rise in policy lapse rates. This led to liquidity shortfalls. Company engaged AQE to assist negotiate an exit strategy with the head insurer. This was designed to maximise the potential return for shareholders and to protect policyholders during a transition period. Board stability over the life of any turnaround plan was unclear. Part of the plan involved obtaining commitments from directors to stay the course of the plan (or, as was the case, for some to withdraw and be replaced with new directors).	Yes	Yes	Medium	Informal and Formal	No	Yes	12 months	The AQE undertook a business review and provided an evaluation of options to the board. The plan subsequently adopted enabled negotiations and sale of trail commission on policyholder premiums, a stable wind down and exit of liabilities via a members voluntary administration process. Employee entitlements were preserved, most employees transferring to the purchaser entity. Creditors were satisfied. SH enabled a controlled and stable process and solvent wind down of the business. This is unlikely to have been possible through an uncontrolled process. An interesting observation is to note the willingness of some directors (notably those without substantial shares in the restructuring company) to stay and execute on a plan. SH accordingly provides more reason for directors to stay both the good and bad times within a company's life-cycle. Directors willing to do so in the tougher trading conditions of a

									turnaround plan ought be commended for their commitment.
Finance	ASX finance company facing Covid derived liquidity pressures. The board, with the help of an AQE, formed the view that the company could be restructured and recapitalised to maintain liquidity. This process would, however, require the support of ~15 lenders and counterparties, some of which had competing interests.	Yes	Yes	Medium	Informal	Yes	Continuing	5 months	The plan led to a refinancing of some lenders, debt for equity swaps for others, the raising of fresh capital and turnaround of business performance. All employees (100) kept jobs, unsecured creditors were paid in full, the balance sheet was deleveraged and the business continues as a trading entity.
Manufacturing	ASX company with more than 1,000 employees, overleveraged balance sheet and declining revenue (impacted by Covid). Senior debt and unsecured amounts owed to landlords and trade parties could not be adequately serviced from the reduced cashflow. AQE engaged to undertake a business review an evaluation, undertake a capital raise and assist in the renegotiation of debt facilities. The AQE was also to implement cost saving initiatives and negotiate compromises with key creditors.	Yes	Yes	Medium	Informal	Yes, in part	Continuing	12 months	The restructure has completed, the ASX entity continuing to trade. Most jobs were saved, noteholders converted debt to equity and unsecured (and secured) creditors continue to be paid in accordance with renegotiated. Equity has been preserved in diluted form. As an observation, it is highly unlikely that jobs would have been preserved, nor would equity have retained some value, if the company had drifted into VA. The restructure maintained an operating entity. The SH regime gave the board confidence to execute on and report against the plan and to provide board stability.

Agricultural	Company was overleveraged - senior and unsecured note facilities together exceeded A$150m. The company explored M+A (takeover) options, which were expected to, and did, involve months of negotiations with debtholders. The company did so having regard to SH principles and continued to satisfy SH pre-requisites. No formal resolution was passed to enter into SH.	No	No	Large	Informal	No	Continuing	12 months	The takeover was completed, new capital injected into the company, debts restructured (consensually). The company continues its existing business and is growing.
Industrial	Experienced liquidity problems when customers unexpectedly reduced order volumes. With 200 employees jobs at stake, facing declining liquidity and high costs structure, the directors needed to consider whether to continue to trade. Directors wished to pursue a dual track process to renegotiate loans facilities (and to refinance these) while running a sale pf business process in tandem.	Yes		Large	Informal	Possibly	Continuing		With the benefit of the SH protection, the directors were successful in the dual track process - loans were refinanced and the business was sold, preserving all 200 jobs.
Technology	The company received an adverse R&D tax ruling which jeopardized its business model and, in turn, its ability to continue as a going concern. The company appealed the tax ruling.	Yes	Yes	Medium	Informal	No	Continuing	6+ months	The R&D appeal was successful. The company continues trading and continues to meet debt obligations as these fall due.

	The directors ensured all SH entry criteria were satisfied and formed a view that a better outcome could be achieved by pursuing an appeal against the adverse R&D ruling (and interesting situation in that the directors needed to take extensive advice on the 'reasonably likely' component of the SH test).								
Energy	Company's cashflow affected when its EPC contractor failed to secure regulatory approvals to connect the newly constructed plant to the relevant grid system. The company needed time to renegotiate arrangements with lenders, source new capital and resolve matters with the regulator.	Yes	Yes	Medium	Informal	No	Continuing	<12 months	With the protection of SH, directors have continued to execute on these strategies and are progressively resolving long term problems while continuing to satisfy debts as these fall due.
Retail	The company has been affected by lockdowns and the inability of its (retail) customers to attend sale promises. The directors continue to meet the SH pre-requisites though have not formally determined to enter SH.	No		Medium	Informal	Yes	Continuing		Directors continue to meet employee entitlements, satisfy other SH obligations and maintain a watch over cashflow. While not, per se, and example of the adoption of a formal SH, two important observations can be drawn (1) SH does not need to be formally entered into in order to provide the protection of 588GAA (2) the fact of SH protection seems to be relatively well known, such that directors are, in unusual trading situations, focusing on the entry criteria as an ordinary part of the business focus of the company and for active consideration by the board of directors.

Transport	The company was suddenly and unexpectedly affected by lockdowns in travel associated with covid. The directors continued to operate the business, taking solvency advice and while continuing to meet the SH criteria (in particular focusing on meeting ongoing employee entitlements). SH was not formally adopted and it is highly doubtful the company was ever trading while insolvent so s588G issues do not naturally arise for consideration.	No		Mega	Formal	Yes	Continuing		It is notable that the SH pre-requisites were under active review by the Board, again emphasising that the approach to dealing with stakeholders and in maintaining integrity in the business is, and remains, part of the business judgments of directors in distressed circumstances.
Investment - other	ASX company business was disrupted by Covid induced disruptions around the supply chain. Board engaged advisors to assist develop a stabilisation and contingency plan. The plan focused on improving values and revenue from under-performing business lines and reassessing creditor terms.	Yes	Yes	Medium	Informal	Yes	Continuing	<3 months	Textbook example of SH, implemented in a timely and efficient manner, without the need for a long tail. Business and the directors regained confidence in the business and deal with the unexpected pressures wrought by covid induced shutdowns. The business stabilised and continues to trade.
Retail	ASX retailer with large leasehold footprint, impacted by a lack of foot traffic during Covid lockdowns. Board determined to enter SH in light of future insolvency risk should the restrictions	Yes	Yes	Medium	Informal	Yes	Continuing	<3 months (twice)	SH was used twice to deal with different lockdown impacts on liquidity. SH provided the board with a level of comfort, enabling the continued trading of the business in conformity with the plan.

	lead to a sustained and ongoing decline in business. The Board engaged external parties to assist with negotiations with landlords, standing down of staff, store re-opening programs, further lockdowns, amending and extending secured lending facilities and negotiations with stakeholders.								Management were encouraged by the AQE (legal and financial advisors) to provide updated materials to enable the AQE to providing advice to the board. The board used that information to maintain trading rather than taking the alternate course (VA). The business remains trading.
Design	Solid performing Australian business that had significant ATO liabilities, multiple failed payment plans and ongoing disputes with a former landlord. Uncertainty overflowing from 2019 market conditions (oversaturated market and ill-fated expansion of the business into SEA) created concerns. VA was under active consideration. The board, with the assistance of AQEs (legal and financial advisory), having ensured SH criteria were met, developed an alternative plan. The pillars of the plan involved engaging with the ATO, landlords and better trading terms with creditors.	Yes	Yes	Small	Informal	No	Continuing	6+ months	Adopting SH allowed the business to continue to trade rather than proceeding into VA. This enabled management to preserve personal relationships with suppliers and creditors and enabled the company to take advantage of increased appetite within Australia for its product (visual effects). This law reform enabled the preservation of a business that, but for SH, would have gone into VA with the sole director losing her retirement 'nest egg'. The business continues to trade and grow. The development of a SH plan with the help of the AQE identified a couple of simple key pillars. The AQE was able to simplify (in the minds of the directors at least) the process for recovery because of experience from previous engagements.
Renewables	SME business hamstrung through increased competition, higher cost base and delayed contract completion as a result of Covid. The business was	No	Yes	Small	Informal	Yes	Continuing		Although the directors chose not to formally adopt SH (because of concerns this would become a disclosure event under facility instruments), on an objective assessment, SH was effectively

	trading to a potential insolvency event (ref flag was the potential for cashflow to impact on the ability to meet payroll). SH was considered at the board level- this led to a better understanding of the criteria for SH and the need to focus any plan on the ability to meet ongoing payroll (and entitlements) as well as trading back to an ability to meet debts as these fell due.								engaged (entry criteria was met, a plan developed with AQEs, solvency measures were restored). Serious consideration needed to be given to the interplay with SH and disclosure requirements under existing secured lending arrangements. In the end, the secured lender was supportive of the engagement of external advisors. It is interesting that the board determined to satisfy the entry requirements of SH and to follow the execution elements of SH but did not see a need to formally resolve to enter SH.
Mining	ASX mineral sands company was under-performing production forecasts (mineral recoveries). The company required assistance in identifying cost saving and revenue improvement initiatives, which were subsequently embedded in the business plan and corporate financial model. Board retained AQE at both the listed and subsidiary level to assist in providing financial advice and in developing a plan for sale of the business for the highest possible price. This required the sale to be negotiated while the company had a continuing business.	Yes	Yes	Medium	Informal	No	Continuing		The AQE identified a number of cost saving/revenue improvements and suggested initiatives to achieve value. The AQE was tasked with business improvements project management and both short and long term cashflow modelling, to assist the company in its negotiations with financiers. The subsequent sale enabled all unsecured creditors (including employee entitlements) to be met. The subordinated creditor retains a royalty stream from ongoing operations.
Architecture - Design	Privately owned group heavily focused on the aged care sector. Negative media led to an unprecedented reduction	Yes	Yes	Medium	Informal	No	Continuing		The adoption of a turnaround plan enabled the company to achieve better outcomes than would have been possible under a VA process. The

	in the Group's revenue and unforeseen financial losses. The board took advice from an AQE to enable it to satisfy SH eligibility criteria and to assist the company work through cost reduction and business improvement initiatives, with the aim of right-sizing the business.								board were able to restructure operations and return to profitability.
Medical	ASX company engaged AQE to assess SH eligibility criteria, review financials of group companies, ensure financial records were complete and position to report compliance with s588GAA.	Yes	Yes	Medium	Informal	No	Continuing		Board developed and executed on a restructuring plan that led to better outcomes than achievable in a VA.
Property	The Group comprised three principal businesses - high end renovation company, smaller home renovations company and a consultancy arm. The Group experienced adverse operational performance and needed additional capital. AQEs engaged to evaluate the company turnaround plan and to provide restructuring options.	No		Small		No			Following review of the Group's financial position and proposed turnaround plan, the AQE advised that the company did not need to formally enter SH.
Print and Distribution -	This ASX entity was successfully restructured using interlocking schemes (both a members scheme and a creditors scheme), capital	Yes	Yes	Large	Informal and Formal	No	Continuing		SH enabled the directors of companies within the Group to engage in restructuring initiatives that resulted in positive outcomes for stakeholders. Without SH, the group would not have

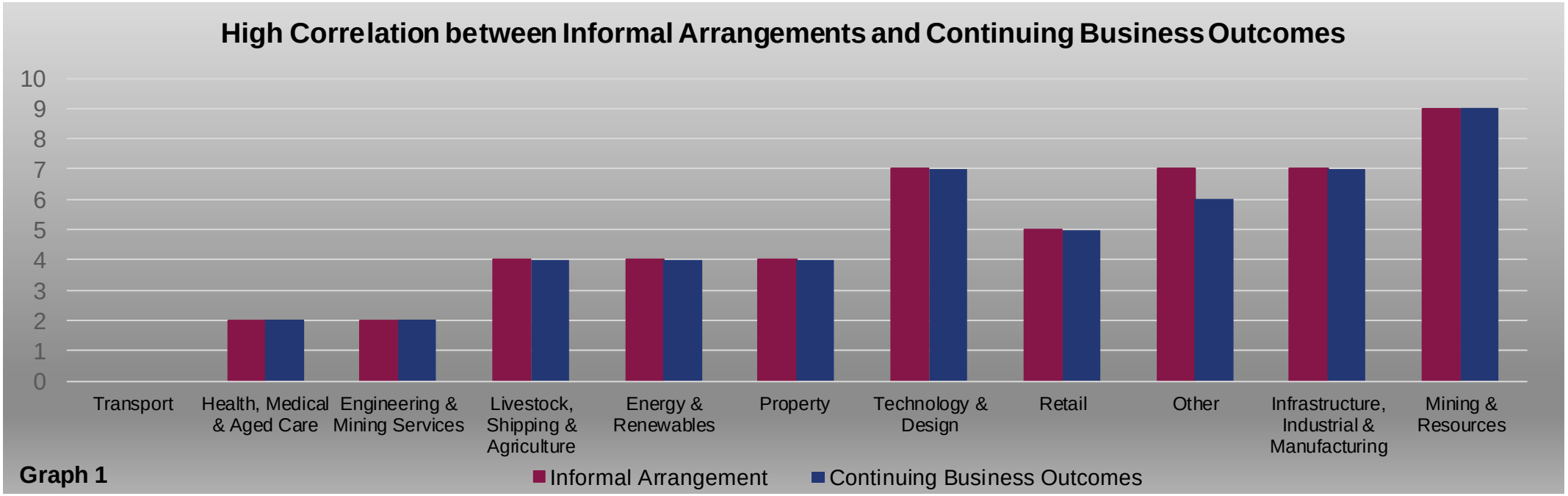
Design + Technology	raising, debt compositions and swaps, operational turnaround strategies and safe harbour planning to avoid insolvency. The restructuring completed on 18 June 2021.								been able to engage in the equity raising, Schemes or other turnaround steps to restore solvency in the Group.
Mining Services	EPC contractor had strong (~$250m) turnover, few tangible assets and a strong forward book. The company came under liquidity pressure because of risks associated with a long and large ongoing claim. The litigation was diverting company attention, creating cashflow pressure (high ongoing legal costs) and risk as the litigation outcome became more real.	Yes	Yes	Large	Informal	No	Continuing		SH advisor was able to create a restructure plan to run in parallel to the litigation. The AQE provided a new and unbiased perspective. This perspective gave the board sufficient information to initiate and conclude settlement negotiations. The company is now out of SH and successfully trading. If not for SH, it is unlikely the company would have engaged the AQE and it is unlikely the board would have considered the liquidity impact of the litigation on its business. It is highly likely that without a settlement of the litigation, there would have been a risk of an adverse outcome. It is probable such an outcome would have led to a VA, termination (or risk of termination) of the forward book and closure of the business.
Retail	Privately owned retailer with operations in a number of jurisdictions and (pre COVID) had run into a range of headwinds impacting both costs and revenue adversely. The directors were concerned about personal liability and invoked safe harbour in order to effect a turnaround plan	Yes	Yes	Small	Informal	No	Continuing	2 months	Additional equity was obtained and the company continues to trade successfully.

	including to negotiate with their existing secured lender and obtain additional equity from existing shareholders.								
Technology	ASX technology company was loss making; invoking the safe harbour enabled directors to put into effect their plan to realise non-core assets, raise further equity and refinance the existing secured debt	Yes	Yes	Small	Informal	No	Continuing	6 months	Additional equity was raised enabling a successful trade.
Technology	The company was a start-up and generating revenue. Its cash burn (expenses) exceeded revenue, which is not unusual in technology start-ups. Directors were concerned that cash would be consumed before the company could sufficiently increase revenue or achieve a sale of the business. The directors availed themselves of safe harbour and continued to trade.	Yes	Yes	Small	Informal	No	Continuing		A sale of the business as a going concern was eventually achieved at a price well above what a likely liquidation would have obtained. All employees continued with their employment and creditors were either paid or absorbed in the transaction
Mining	Company had an event on site which halted production. Without production there was no revenue but holding costs were still being incurred. There was a plan to re-start the mine but it was	Yes	Yes	Large	Informal	No	Continuing	<6 months	The directors availed themselves of safe harbour while the technical aspects of the mine re-start were attempted, and while a capital raise was undertaken. After several months the mine was re-started and the capital raise was

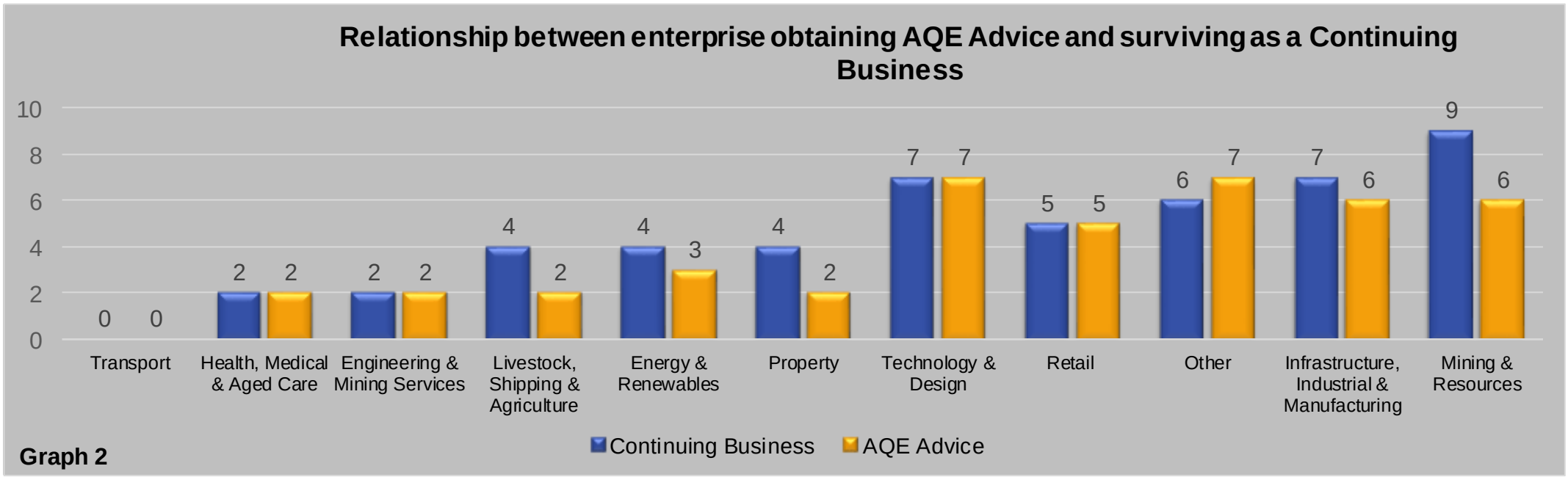
	not certain the plan would work.								successful. The mine continues in operation 2 years later
Other - unknown	A company failed in litigation and received a significant adverse judgement debt. The debt was due and payable and exceeded its assets. The directors believed there were reasonable prospects to negotiate an acceptable settlement as, for a range of reasons, the other party would not want to see them fail.	Yes	Yes	Medium	Informal	No	Continuing		The negotiations were expected to (and did) take some time to conclude as they involved a counter-party which operated in several jurisdictions and had a complex governance structure. The directors entered safe harbour while the negotiations were commenced and concluded. The negotiations were ultimately successful and the company was able to continue to trade.

Appendix C

CLAYTON UTZ



Graph 1



Graph 2

Review of the **Insolvent Trading Safe Harbour** REPORT

November 2021

Review of the Insolvent Trading Safe Harbour

Report

23 November 2021

Manager
Media and Speeches Unit
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PART I
INTRODUCTION AND OVERVIEW

Letter to the Minister from the Panel

Dear Assistant Treasurer

Review of the insolvent trading safe harbour

The Commonwealth announced in the 2021-22 Budget that it would commence an independent review into the insolvent trading safe harbour to ensure the provisions remain fit for purpose and their benefits extend to as many businesses as possible.

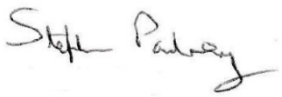
An independent panel was appointed to undertake the Review. The Review has involved extensive consultation with a broad range of stakeholders, including receipt of 20 written submissions, and participation in numerous round table discussions. In addition to the submissions, throughout this process we have benefited from insights from colleagues, academics, directors and insolvency advisers who have given their time generously to enrich our review of these important safe harbour provisions.

In accordance with section 588HA of the *Corporations Act 2001* (Cth), we are pleased to present you with the Review of the Insolvent Trading Safe Harbour.

We would be happy to meet with you to discuss our recommendations.

Yours sincerely,





Genevieve Sexton | Leanne Chesser | Stephen Parbery

Panel members

Ms Genevieve Sexton – Panel chairperson

Ms Sexton is a partner at Arnold Bloch Leibler. She is experienced in solvent and insolvent restructuring and workout transactions, advising distressed companies, insolvency practitioners, directors, lenders and other stakeholders in some of Australia's largest and most complex restructures. Genevieve holds a Bachelor of Arts and Bachelor of Laws (Hons), both from Monash University.

Ms Leanne Chesser – Panel member

Ms Chesser is a partner at KordaMentha and a Registered Liquidator. She is a current Australian Restructuring Insolvency & Turnaround Association (ARITA) Board Member and Chair of the ARITA Vic/Tas Committee. She holds a Bachelor of Commerce from the University of Melbourne.

Mr Stephen Parbery – Panel member

Mr Parbery is a senior adviser at Duff & Phelps-Kroll. He was previously a founder and chairman of PPB Advisory. He is a former president and life member of ARITA. He is a fellow of the Institute of Chartered Accountants. He is a member of the ministerial pool for the Insolvency Practitioner Registration and Disciplinary Committees.

1. Acknowledgements

The Panel would like to thank stakeholders who have provided their time and expertise in round table discussions and informal discussions, as well as through written submissions. We have benefited greatly from their depth of experience and insights.

The Panel would like to thank Alexandra Harrison-Ichlov and Elizabeth Kuiper for their assistance and dedication in assisting the Panel in finalising this Report and for acting as the Review secretariat.

2. Review

2.1 Purpose of the review

The safe harbour provisions contained in sections 588GA and 588GB of the *Corporations Act 2001* (Cth) (**Act**) commenced on 18 September 2017 and have now been in operation for just over 4 years.

Section 588HA of the Act provides for an independent review to be conducted for the purpose of examining and reporting on the impact of the availability of the safe harbour to directors of companies on:

- the conduct of directors; and
- the interests of creditors and employees of those companies.

The purpose of this Review is to assess whether the safe harbour is achieving its aims, including giving financially distressed but viable companies more 'breathing space' to restructure their affairs.

2.2 Terms of reference

The terms of reference for this Review are to:

1. examine and report on the impact of the availability of the safe harbour (provided for by sections 588GA and 588GB of the Act) on:
    a. the conduct of directors, including decisions to seek advice about the company's financial position or to undertake a corporate restructure or turnaround plan outside a formal insolvency process
    b. the conduct of directors of small and medium-sized enterprises and any particular issues experienced by these directors when engaging with financial distress
    c. the interests of creditors and employees of those companies, including benefits gained under a successfully implemented restructure or turnaround plan or in formal insolvency processes
    d. the effectiveness of the underlying prohibition on insolvent trading and associated penalties, and
2. examine and report on the role of advisers in the safe harbour.

2.3 Methodology

The Panel received 20 written submissions from a broad range of industry participants in response to a consultation paper. A copy of the consultation paper is attached as Annexure F. A list of the public written submissions received by the Panel can be found in Annexure A.

The Panel also engaged in many round table discussions addressing the questions posed in the consultation paper, including with representatives of ASIC, employees of the Attorney-General's Department involved in administering the Fair Entitlements Guarantee (**FEG**) scheme, academics, law firms, insolvency practitioners, safe harbour specialists, industry representative organisations and the Australian Institute of Company Directors (**AICD**). A list of the formal round table discussions can be found in Annexure B. We also had numerous informal discussions with directors and advisers about their interactions with, and experiences of, the safe harbour provisions. In this Report, we refer collectively to the written submissions and the feedback received through round table discussions, as the Panel's 'consultation process'.

The consultations provided the opportunity for interested members of the community to share their experiences under the current law and regulatory settings and to discuss any potential reforms.

2.4 Timing

The Panel was given 3 months to undertake a consultation process with stakeholders and deliver its Report to the Assistant Treasurer. Pursuant to section 588HA(4) of the Act, the Minister will then table this Report in Parliament.

3. Executive Summary

For some time, company directors in Australia have been subject to a strict duty to prevent a company from engaging in insolvent trading. Directors who breach this duty may be held personally liable for those debts. This threat of personal liability has been described as a 'sword of Damocles', hanging over the head of directors of financially distressed companies and distorting the lens through which they contemplate potential turnaround options.

The safe harbour reforms were intended to shift directors' focus from personal liability for insolvent trading, and encourage them to engage in greater innovation and entrepreneurship when pursuing turnaround options for their companies.

Although just over four years have passed since the safe harbour provisions were introduced, the COVID-19 pandemic and its unprecedented impact on all aspects of Australian life over the past 18 months has hampered the assessment of the efficacy of the provisions as they would apply under more conventional circumstances. Businesses and corporations have been greatly affected by COVID-19 restrictions, lockdowns, and the prevailing uncertainty brought about by the pandemic. The mix of public capital stimulus (including JobKeeper and JobSeeker payment schemes, rent abatements and the COVID-19 insolvent trading moratorium), together with the low cost of private capital, has led to an environment where – at least anecdotally – many companies appear to be treading water, but relatively few formal insolvency appointments have been made.

Safe harbour is also not a public process. It relates to confidential board decisions and does not usually become public unless the company enters a formal insolvency process (and even then, there is little public data available). There are good reasons for this: publicising a company's financial distress during a period of safe harbour can have dire consequences for its liquidity and ongoing ability to trade.

Accordingly, when conducting this review, the Panel has relied almost entirely on input received from advisers, directors and other stakeholders as to their experiences of the safe harbour provisions.

3.1 Stakeholder submissions

Throughout the Panel's extensive consultation process, two main issues emerged:

- the appropriateness and efficacy of the safe harbour provisions and whether improvements or amendments are required; and
- the appropriateness and efficacy of the insolvent trading prohibition more generally and whether there should be a holistic reconsideration of the framework of directors' duties as they intersect with corporate distress and/or failure.

In addition, stakeholders referred to:

- the lack of awareness and understanding of a director's duty to prevent insolvent trading (and the related safe harbour carve-out) with many stakeholders noting that this was a key factor which has prevented directors from more readily engaging with the safe harbour provisions; and
- the difficulties faced by having a single insolvency law framework that applies to all sizes and types of companies. In this respect, there was clear consensus between stakeholders that the safe harbour protections and the prohibition on insolvent trading have greater resonance with, and application to, larger companies and/or more sophisticated boards.

When considering how these issues could be addressed, the Panel had regard to the following proposals, which received almost unanimous support among stakeholders:

- increasing awareness and education of the safe harbour provisions, the related duty to prevent insolvent trading and general directors' duties; and
- conducting a broad review of Australia's insolvency laws.

3.2 Recommendations

The Panel's recommendations are set out in Part VI. Whilst the focus of those recommendations is on the wording of the safe harbour provisions themselves, the Panel has also endorsed the need for ongoing education and guidance to support the operation of the legislative provisions and promote awareness of them amongst stakeholders. The Panel is keenly aware that there is currently no ASIC guide or industry-endorsed best practice guide as to how the safe harbour provisions operate in practice. Therefore, a number of the Panel's recommendations are aimed at simplifying the provisions or clarifying their meaning, so that they can be readily understood and applied.

Overall, the Panel considers that within the construct of a regime which imposes strict liability for insolvent trading, the safe harbour protections offer considerable assistance in encouraging an active turnaround market, particularly for larger companies. The case studies submitted by stakeholders demonstrate many examples where stakeholders, including creditors and employees, have benefited from the increased runway provided to directors (through the safe harbour provisions) to achieve operational restructures. However, the Panel holds concerns as to the relevance and applicability of the safe harbour (and, indeed, the underlying prohibition on insolvent trading) to the SME market.

It is also timely for serious consideration to be given to a holistic review of Australia's insolvency regime. More than 30 years have passed since the release of the last comprehensive review of Australia's insolvency laws; the Harmer Report.[1] The Harmer Report acknowledged that economic and social changes had given rise to a need for a review of insolvency law and procedure.[2] We find ourselves in a similar position today. The last 30 years have seen unprecedented globalisation, and immense changes to the ways in which Australia's capital markets operate. During that period, Australia has also adopted the UNCITRAL Model Law on Cross-Border Insolvency,[3] to assist in addressing complexities in cross-border insolvencies, and in recognition of the global environment in which many Australian companies operate.

To state the obvious, it is important that Australia's insolvency laws remain fit-for-purpose and consistent with community expectations about how a company is to be governed and managed at each stage of its life cycle. A comprehensive review that not only considers the past 30 years of jurisprudence on our current insolvency regime, but also assesses the impact of our insolvency laws on our trading partners, on domestic and international capital markets and other economic and social factors, would be a significant and invaluable development.

1 Australian Law Reform Commission, General Insolvency Inquiry [1988] ALRC 45.
2 Australian Law Reform Commission, General Insolvency Inquiry [1988] ALRC 45, p 1.
3 Enacted by the *Cross-Border Insolvency Act 2008* (Cth).

4. Introduction

This Report considers the operation of the safe harbour provisions contained in sections 588GA and 588GB of the Act together with relevant ancillary provisions. All references in this Report to the Act are, unless otherwise noted, references to the *Corporations Act 2001* (Cth), and all references to safe harbour, unless otherwise noted, are references to sections 588GA and 588GB of the Act. The Panel recognises that the safe harbour is a legislative carve-out to the underlying prohibition on insolvent trading in the Act and has provided analysis on this basis. However, the safe harbour is also a concept that needs to be readily understood by directors. The Panel notes that the idea of the safe harbour as a 'defence' or a 'harbour' in which to moor appears to resonate with many directors who may need to rely on it. We do not feel it necessary to get stuck on semantics. Therefore, any references in this Report to the safe harbour 'defence', 'being in' and/or 'entering into' safe harbour should be understood as a director seeking to rely on the safe harbour legislative carve-out to the prohibition on insolvent trading.

Throughout this Report, reference is made to small and medium-sized enterprises (**SMEs**), 'SME companies' and the 'SME market'. However, from the Panel's consultation process, it is clear there is no uniform view of what constitutes a SME.[4] The Australian Bureau of Statistics (**ABS**) defines small businesses as employing 0-19 employees and medium businesses as employing 20-199 people.[5] While this serves as a general guide to defining a SME company, there are many who would not consider a company that employs close to 200 people as an SME. As a result, when referring to SMEs, the Panel has also had regard to other factors associated with SMEs including that they usually have common owners and management, minimal internal accounting resources and thin levels of capital.

Our references to medium or mid-market companies are those whose enterprise value may not be considered large, but which fall in between SMEs and large corporates. They typically have more disperse owners and managers, and greater levels of capital than an SME.

When considering the discussion points and recommendations received as part of the Panel's consultation process, it became clear that the content of most submissions fell into 2 broad categories. First, many submissions considered the terminology of the safe harbour provisions and how they should be interpreted. In this Report, we refer to these considerations as the **Legislative Considerations**. Second, many submissions considered the broader framework within which the prohibition on insolvent trading sits, including how it interacts with other directors' duties and unfair preferences. In this Report, we refer to these considerations as **Other Considerations**.

The Report is divided into 5 parts:

- First, we outline the prohibition on insolvent trading and the context in which the safe harbour provisions were introduced.
- Second, we consider the impact of the introduction of the safe harbour provisions and how they operate in practice.

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4 By way of example, some parties consider 'micro' businesses as those with a turnover of up to $1 million per annum, while others consider micro businesses as having a turnover of up to $5 million per annum. Similarly, some parties consider the 'small' companies in the SME market to have an enterprise value of between $10 million and $50 million (with an even greater enterprise value for 'medium' companies in the SME market), whereas other parties view SMEs as having an annual revenue of between $1 million and $10 million.

5 Australian Bureau of Statistics website: <https://www.aph.gov.au/about_parliament/parliamentary_departments/parliamentary_library/pubs/rp/rp1516/quick_guides/data>.

- Third, we outline the main Legislative Considerations, discuss the issues raised and consider whether improvements are necessary or desirable.
- Fourth, we examine the issues raised as Other Considerations, notably the overwhelming feedback for a holistic review of Australia's insolvency laws.
- Fifth, and finally, we include a list of recommendations.

This Report also refers to the recently introduced provisions aimed at combatting illegal phoenixing,[6] and those implementing the Small Business Restructuring (**SBR**) framework.[7] The Panel did not receive any detailed submissions that considered the application of the safe harbour vis-à-vis these provisions. Given this, and the recency of their enactment, this Report touches on them only briefly.

Finally, we note that the views of the Panel members expressed in this report are expressed in their personal capacity and are not to be viewed as representative of their places of work, or any industry bodies of which they are members.

6 *Corporations Act 2001* (Cth) ss 588FDB and 588FE(6A).
7 *Corporations Act 2001* (Cth) s 588GAAB.

5. Context of Safe Harbour

5.1 Insolvent trading: what is it?

To understand what is meant by 'safe harbour', it is necessary to consider what safe harbour offers protection from.

In Australia, directors have a strict duty under section 588G of the Act to prevent insolvent trading by a company. A director can be held personally liable for debts incurred by a company while it is insolvent, if at the time the debt was incurred, the director was aware there were reasonable grounds to suspect that the company was insolvent (or would become insolvent by incurring that debt), or if a reasonable person in a like position in a company in the company's circumstances would be so aware.[8] Section 588G is a civil penalty provision,[9] meaning a director's contravention of the duty may result in a court making orders including a pecuniary penalty order, or disqualifying the director from managing corporations.[10] Criminal sanctions may also apply where the failure to prevent the company incurring the debt was dishonest.[11]

The party seeking to establish that a breach of the duty has occurred bears the burden of proving its elements. Those elements are as follows.

a) Debts

The company must have incurred a debt.[12] Section 588G is concerned with *debts* as opposed to all *liabilities*. The term 'debt' is not defined in the Act. However, it is accepted that a debt constitutes a liability to pay a liquidated amount, even if the liability to pay is contingent.[13] Accordingly, unliquidated or 'unascertained' claims, such as a liability to pay an unliquidated amount of damages for breach of contract, are not regarded as debts for the purpose of section 588G.[14] Section 588G(1A) also contains a list of actions which may be taken by a company which result in a debt being incurred, such as the payment of a dividend or the company's entry into a buy-back agreement for shares.[15] Determining when a debt is incurred otherwise turns on when the company is exposed to the

8 *Corporations Act 2001* (Cth) ss 588G and 588J. See also s 1317H.
9 *Corporations Act 2001* (Cth) s 1317E.
10 *Corporations Act 2001* (Cth) ss 1317G and 206C.
11 *Corporations Act 2001* (Cth) s 588G(3).
12 *Corporations Act 2001* (Cth) s 588G.
13 See *Hawkins v Bank of China* (1992) 26 NSWLR 562, 572 (Gleeson CJ). In the recent case of *Quin v Vlahos* [2021] VSCA 205, the Victorian Court of Appeal stated, with respect to the meaning of 'debt' in section 588G, that '[a] useful starting point is the ordinary legal meaning of a debt, being 'a sum of money which is now payable or will become payable in future by reason of a present obligation' (at [250], citations omitted).
14 *Shephard v Australia & New Zealand Banking Corp Ltd* (1996) 41 NSWLR 431; see also *Re Simmoll Pty Ltd* [2021] VSC 693, [45] (Hetyey AsJ). Although, the law in relation to the status of unliquidated claims in the assessment of a company's solvency is unsettled: see, for example, L Powers, 'The Impact of Unliquidated Claims When Assessing Solvency: A Director's Dilemma' (2017) 32 Aust Jnl of Corp Law 368.
15 *Corporations Act 2001* (Cth) s 588G(1A).

relevant liability as a matter of commercial reality.[16] There must be no other action that the company can take to avoid the obligation to pay.[17]

Submissions received by the Panel queried why section 588G should be limited to only 'debts'. As an example, 2 submissions queried why the issuance of a gift card the day before an appointment of an administrator should not also constitute a debt within the meaning of section 588G.[18] The Panel has not formed a view as to the merits of the present construction of a debt for the purpose of the insolvent trading prohibition, and believes it is outside the ambit of this Review to consider whether the underlying prohibition should extend to a broader definition of liabilities (and if so, what those additional liabilities should be). The concept of a debt as interpreted in the insolvent trading context has application in other contexts, including statutory demands.[19] Accordingly, any reconsideration of debts and liabilities should be done as part of a holistic review of Australia's insolvency laws.

b) Insolvency

The company must have been insolvent at the time the debt was incurred or it must have become insolvent as a result of incurring debts which include the relevant debt.[20] The focus of section 588G is, therefore, insolvency; either the existence of insolvency at the time the debt was incurred or the consequence of insolvency from the debt being incurred. It requires directors to comprehend the nuanced distinction between financial distress and insolvency. It also requires directors to, prima facie, bear the risk of a company trading while insolvent. For that reason, prior to the introduction of the safe harbour provisions, the Australian corporate regulatory framework was described as the strictest in the world.[21] Some say it remains so.[22]

The concepts of solvency and insolvency are defined in section 95A of the Act, which states that:

- a person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable, and
- a person who is not solvent is insolvent.[23]

Section 95A adopts a cashflow test of insolvency which turns upon the cash sources available to the company and the expenditure obligations that it has to meet. An alternative balance sheet test, which examines whether a company's liabilities exceed the value of its assets, can provide context for the application of the cashflow test.[24] The cashflow test provides only a starting point for the analysis: the statutory emphasis is on solvency and not liquidity.[25] Solvency is a question of fact to be determined by reference to the company's financial position taken as a whole, viewed in light of commercial realities.[26] This requires a court to consider the nature of the company's business, its recent trading history, its current assets, its ability to realise other assets, its ability to borrow money

16 *Australian Securities and Investments Commission v Plymin* (No 1) (2003) 175 FLR 124, [516] (Mandie J); *Re Overgold Pty Ltd* [2019] VSC 624, [9]-[19] (Gardiner AsJ).
17 *Hawkins v Bank of China* (1992) 26 NSWLR 562.
18 ARITA submission, p 23 of Appendix B; Wellard submission, p 8.
19 *Re Simmoll Pty Ltd* [2021] VSC 693, [45]-[51] (Hetyey AsJ).
20 *Corporations Act 2001* (Cth) s 588G.
21 Chief Justice Wayne Martin, 'Official Opening Address' (Speech delivered at Insolvency Practitioners' Association of Australia Conference, Burswood Entertainment Complex, 28 May 2009).
22 For example, the AICD/BCA noted that 'Australia's insolvent trading rules remain among the strictest in the world.' (AICD/BCA submission, p 3).
23 *Corporations Act 2001* (Cth) s 95A.
24 *Re Swan Services Pty Ltd (in liq)* [2016] NSWSC 1724, [136] (Black J).
25 N F Coburn, *Coburn's Insolvent Trading* (Lawbook Co, 2nd ed, 2003), p. 66, as cited in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1, [1073] (Owen J).
26 *Southern Cross Interiors Pty Ltd v Deputy Commissioner of Taxation* (2001) 53 NSWLR 213, 224 [54] (citations omitted) (Palmer J); *Sandell v Porter* (1966) 115 CLR 666, 670 (Barwick CJ).

(with or without security) in time to meet its debts and its overall asset and liability position.[27] The courts have recognised a number of indicators, or common features, of insolvency,[28] although their significance will vary from case to case.[29]

Solvency under section 95A is to be assessed by reference to those circumstances that were known or knowable at the relevant time.[30] The test, however, calls for a 'degree of forward-looking'.[31] That is, it is relevant to consider a company's ability to pay future debts. The company's circumstances dictate how far into the future that assessment must extend.[32] However, insolvency on the basis of a company's inability to pay long-term debts, being those debts that are not payable immediately or in the near future, is difficult to establish. This is because it is difficult to show to a sufficient degree of likelihood that, as at the date of alleged insolvency, the company would not be able to repay its debts when they fall due in the future.[33]

c) Reasonable grounds to suspect insolvency

The director must have failed to prevent the company from incurring a debt in circumstances where the director was either objectively aware, or where a reasonable person would have been so aware,[34] that there were reasonable grounds to suspect that the company was insolvent or would become insolvent when the debt was incurred.[35]

The prohibition on insolvent trading is concerned with 'the timing of when debts are incurred by a company rather than the conduct of the directors in incurring that debt'.[36] Personal culpability is, therefore, less relevant to the prohibition on insolvent trading under section 588G when compared with other directors' duties. This is because section 588G does not require that a director's actions are dishonest or fraudulent, nor does it require that a director subjectively knew that their company was insolvent when they incurred the debts.[37] That being said, the director's state of mind *is* relevant to characterising the nature of the contravention (for example, whether the breach is civil or criminal) and ascertaining the appropriate penalty.[38]

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27 *Barboutis v Kart Centre Pty Ltd (No 2)* [2020] WASCA 41, [121] (Buss P, Mitchell and Vaughan JJA); *The Bell Group Ltd (in liq) v Westpac Banking Corporation* (No 9) (2008) 39 WAR 1, [1090] (Owen J).

28 *Australian Securities and Investments Commission v Plymin (No 1)* (2003) 175 FLR 124, [386] (Mandie J); *Smith v Boné* (2015) 104 ACSR 528, [31]-[32] (Gleeson J).

29 *Lewis, Re Damilock Pty Ltd (in liq) v VI SA Australia Pty Ltd* (2008) 252 ALR 533, [16] (Mansfield J).

30 *Lewis v Doran* (2005) 219 ALR 555, [103] (Giles JA, Hodgson JA and McColl JA agreeing); *Re Swan Services Pty Ltd (in liq)* [2016] NSWSC 1724, [136] (Black J).

31 *Westgem Investments Pty Ltd v Commonwealth Bank of Australia Ltd (No 6)* [2020] WASC 302, [1057] (Tottle J); see also *Duncan v Commissioner of Taxation, Re Trader Systems International Pty Ltd (in liq)* (2006) 58 ACSR 555, [39] (Young J); *Expo International Pty Ltd v Chant* (1979) 2 NSWLR 820, 839 (Needham J).

32 *Lewis v Doran* (2005) 219 ALR 555, [100]-[104] (Giles JA, Hodgson JA and McColl JA agreeing); *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* (2008) 39 WAR 1, [1128] (Owen J); *Re Cube Footwear* [2013] 2 Qd R 501, [50]-[55] (Jackson J); *Barboutis v Kart Centre Pty Ltd (No 2)* [2020] WASCA 41, [123] (Buss P, Mitchell and Vaughan JJA).

33 See *Anchorage Capital Master Offshore Ltd v Sparkes (No 3); Bank of Communications Co Ltd v Sparkes (No 2)* [2021] NSWSC 1025, [265]-[267], [298] (Ball J).

34 A reasonable person in this context is a director of ordinary competence who is capable of reaching a reasonably informed position about the financial capacity of the company: *Credit Corp Australia Pty Ltd v Atkins* (1999) 30 ACSR 727, 741 (O'Loughlin J); *Australian Securities and Investments Commission v Plymin (No 1)* (2003) 175 FLR 124, [423] (Mandie J).

35 *Corporations Act 2001* (Cth) s 588G(1)(c).

36 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017 [1.6].

37 *Green, Arimco Mining Pty Ltd (in liq) v CGU Insurance Ltd* (2008) 67 ACSR 398 (Einstein J).

38 *Australian Securities and Investments Commission v Plymin (No 1)* (2003) 175 FLR 124, [426] (Mandie J).

d) Defences

Section 588H of the Act outlines limited statutory defences that are available to a director who has engaged in insolvent trading.[39] Namely, that the director:

- had reasonable grounds to expect solvency
- placed reasonable reliance on information provided by others as to the company's solvency
- had a justifiable reason not to participate in the management of the company at the time the debt was incurred, or
- took all reasonable steps to prevent the company from incurring the debt.[40]

None of the aforementioned defences permit a director to knowingly engage in insolvent trading. Rather, the defences provide relief in circumstances where the director was unaware of the debt or actively attempted to prevent the debt from being incurred.

The court also possesses a broad discretion under sections 1317S and 1318 of the Act to excuse a director from liability where they have acted honestly and ought fairly be excused in the circumstances of the case.[41]

The safe harbour provisions provide a carve-out to the civil liability of directors under section 588G(2). However, they are not a carve-out to the criminal offence set out in section 588G(3). The Panel's consultation process did not reveal any concerns with the operation of the criminal offence for insolvent trading contained in section 588G(3). However, we note that this provision has rarely been engaged in practice.

e) Reflections on assessing insolvency

As can be seen from the above analysis, there is complexity in establishing solvency and insolvency under section 95A of the Act. This can make it difficult for directors to assess whether they are complying with the law.

In the period prior to an insolvency appointment, the major focus by directors is on cash flow, given its direct correlation with solvency. The balance sheet is relevant only to the extent that consideration is given to assets to be sold or pledged for the purpose of providing working capital or to repay debt. However, once an insolvency appointment occurs, the focus of stakeholders diverts to the balance sheet and whether the company has sufficient realisable assets to meet its liabilities.

Separately, the nature of a balance sheet pre-appointment and post-appointment can differ materially due to a variety of reasons, including:

- employee notice and redundancy provisions crystallising
- long-term lease liabilities (in particular landlord claims) being brought forward
- cash being swept by secured creditors under security arrangements
- an increase in the number of debtors claiming they are not obliged to pay amounts outstanding
- asset values being impacted by 'forced sale' implications as opposed to 'going concern' implications, and
- the value of many intangible assets, which can sometimes be a significant part of a balance sheet (such as goodwill), disappearing.

39 *Corporations Act 2001* (Cth) s 588H.
40 *Corporations Act 2001* (Cth) s 588H(1)–(4).
41 *Corporations Act 2001* (Cth) s 1317S.

Due to the complexities in assessing solvency, experts often disagree as to whether a company is solvent or not. Different opinions can arise in relation to asset values, the extent of liabilities, and the borrowing capacity of a company. There can also be differences of opinion as to whether trading results and cash flow projections were prepared on reasonable assumptions. These complexities create uncertainty for both directors and creditors, as was evidenced in the recent *Arrium* judgment.[42] Further, solvency is not a fixed state: companies can go in and out of solvency, depending on their liquidity, trading conditions and the capitalisation of the company (among other things). Pinpointing a company's solvency at any given time can be a very difficult, multifaceted analysis that even experienced judges and insolvency experts find challenging, yet section 588G requires the common director to do just that.

5.2 Purpose of insolvent trading laws

When a company is insolvent, or nearing insolvency, there is a misalignment between the interests of the traditional stakeholders of that company (being its shareholders), and the interests of its creditors. In such circumstances, most jurisdictions (Australia included) regulate the directors' conduct to:

- protect creditors by ensuring that any remaining assets of a company are not further diminished and, also, to provide a form of recourse for creditors to recoup their financial losses in the event of liquidation, and
- encourage responsible directorial action as part of the broad suite of duties imposed on company directors.

The positive duty to prevent insolvent trading was introduced into the former *Corporations Act 1989* (Cth) by the *Corporate Law Reform Act 1992* (Cth). The *Corporate Law Reform Act 1992* (Cth) implemented recommendations from the Harmer Report.[43] Underpinning the Harmer Report's recommendations was a policy position that some of the risk for insolvent trading should be borne by directors. It was acknowledged that directors should be 'accountable for irresponsible behaviour, particularly where it affects creditors of the company'.[44]

Risk allocation is central to insolvent trading provisions. Who ought to bear the cost of failure permeates all substantive analysis of the underlying effectiveness of the prohibition on insolvent trading and the safe harbour provisions. In what circumstances, and to what extent, the risk of corporate failure should be borne by creditors, directors, advisers or the Commonwealth is a question that goes to the heart of Australia's insolvency regime. In allocating the risk, insolvent trading provisions attempt to strike a balance between protecting creditors' rights and preserving businesses.

In introducing the safe harbour regime in 2017, the Commonwealth was critical of how the threat of Australia's insolvent trading laws, coupled with uncertainty over the precise moment a company becomes insolvent, led directors to seek voluntary administration even when the company may be viable in the long term.[45] The insolvent trading provisions were never meant to be draconian and punitive, rather, they were intended to incentivise responsible conduct and companies 'putting their hand up' early.

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42 *Anchorage Capital Master Offshore Ltd v Sparkes (No 3)*; *Bank of Communications Co Ltd v Sparkes (No 2)* [2021] NSWSC 1025.

43 Explanatory Memorandum to the Corporate Law Reform Bill 1992 (Cth), Part 4.

44 Australian Law Reform Commission, General Insolvency Inquiry [1988] ALRC 45, Chapter 7, p 121.

45 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p 3.

In recognising this, the safe harbour provisions are not only a re-allocation of the risk of corporate failure (away from directors). They also reflect a policy that the purpose of the insolvent trading provisions is not just protection of creditors, but also a governance tool to encourage directors to take a more proactive approach to restructuring the company and returning it to viability, where possible.

The impact of safe harbour in terms of shifting the distribution of risk between stakeholders has likely not yet been seen in full. The lack of recent insolvencies is primarily due to the unprecedented developments that have taken place over the past 2 years, including the introduction of the COVID-19 moratorium, government stimulus packages, the National Cabinet Mandatory Code of Conduct: SME Commercial Leasing Principles during COVID-19, reduced ATO recovery initiatives, interest and loan repayment holidays offered by the major banks, and the general forbearance of creditors throughout the pandemic.[46]

5.3 Background to safe harbour introduction

In 2016, the Commonwealth released the Improving Bankruptcy and Insolvency Laws: Proposals Paper (**Proposals Paper**). The Proposals Paper raised the possibility of introducing a safe harbour to limit the risk of personal liability for directors of an insolvent company where the directors become involved in restructuring efforts.[47] It argued that a safe harbour would strengthen Australia's start-up culture by encouraging entrepreneurship including by assisting start-ups to attract experienced and talented board members.

Adopting one of the 2 alternate models advanced in the Proposals Paper, the Commonwealth introduced safe harbour provisions into the Act via the *Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017* (Cth).

The Explanatory Memorandum to the *Treasury Laws Amendment (2017 Enterprise Incentives No 2) Act 2017* (Cth) noted that current insolvent trading laws 'put too much focus on stigmatising and penalising failure'.[48] The safe harbour reforms aimed to promote 'a culture of entrepreneurship and innovation which will help drive business growth, local jobs and global success.'[49]

The key (overlapping) purposes of safe harbour were identified as:

- promoting a culture of entrepreneurship and innovation, as well as reducing the stigma of failure associated with insolvency[50]
- protecting honest and diligent company directors from personal liability when pursuing a restructure outside formal insolvency[51]
- encouraging company directors to keep control of their company by engaging early with possible insolvency and taking reasonable risks to facilitate the company's recovery[52]

46 Deloitte submission, p 4.
47 Proposals Paper (Improving Bankruptcy and Insolvency Laws) 2016.
48 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p 3.
49 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p 3.
50 Second Reading Speech - Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p4908.
51 Second Reading Speech - Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p 4907.
52 Second Reading Speech - Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p 4907.

- reducing instances of otherwise viable companies proceeding to a formal insolvency process prematurely,[53] and
- where companies do enter a formal insolvency process, they will have a better chance of being turned around or of preserving value for creditors and shareholders, which in turn will promote the preservation of enterprise value for companies, their employees and creditors.[54]

5.4 Overview of safe harbour

The safe harbour provisions establish a carve-out to the insolvent trading prohibition and (in contrast to that prohibition) are centred on the conduct of directors when incurring debts.

In essence, they provide that the insolvent trading prohibition does not apply to company directors who, after beginning to suspect their company is or may become insolvent, start developing one or more courses of action that are 'reasonably likely to lead to a better outcome for the company'.[55] A better outcome is defined as 'an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, of the company'.[56]

Matters that may be considered in working out whether that course of action is 'reasonably likely to lead to a better outcome for the company' include that a company director is:

- properly informing themselves of the company's financial position
- taking appropriate steps to prevent misconduct by company officers or employees that could adversely affect the company's ability to pay all its debts
- taking appropriate steps to ensure the company is keeping appropriate financial records consistent with its size and nature
- obtaining advice from an appropriately qualified entity, or
- developing or implementing a restructuring plan for the company to improve its financial position.[57]

To access safe harbour protection, the company is required to have substantially paid its employee entitlements and have substantially up-to-date tax lodgements.[58]

Directors will be protected by safe harbour unless, or up until the point at which:

- they fail to take the course(s) of action developed within a reasonable period
- they cease implementing the course(s) of action
- the course(s) of action ceases to be reasonably likely to lead to a better outcome for the company, or
- an administrator or liquidator of the company is appointed.[59]

A director who wishes to rely on safe harbour in response to a claim for breach of their duty to prevent insolvent trading bears the evidential burden of demonstrating they are entitled to safe

53 Second Reading Speech - Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p 4908.
54 Second Reading Speech - Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), p 4908.
55 *Corporations Act 2001* (Cth) s 588GA(1).
56 *Corporations Act 2001* (Cth) s 588GA(7).
57 *Corporations Act 2001* (Cth) s 588GA(2).
58 *Corporations Act 2001* (Cth) s 588GA(4).
59 *Corporations Act 2001* (Cth) s 588GA(1)(b).

harbour protection (namely, that they satisfy the requisite elements and pre-conditions outlined in the provisions).[60]

There is also a parallel safe harbour provision which applies to holding companies in respect of their subsidiaries.[61]

The safe harbour provisions are extracted in full in Annexure C.

5.5 Overview of small business restructuring safe harbour

Section 588GAAB of the Act, which came into effect earlier this year as part of the adoption of the SBR reforms, provides a simplified safe harbour for SMEs undertaking a restructure. The SBR provisions are extracted in full in Annexure D.

The SBR reforms aim to provide a simpler, faster and more cost-effective insolvency process for SMEs to restructure,[62] and include the following key features:[63]

- total liabilities[64] of the company must not exceed $1 million (excluding any employee entitlements owing)
- none of the directors or the company (nor anyone who was a director in the past 12 months) may have used the restructuring or simplified liquidation process within the last 7 years
- all tax lodgements must be brought up to date by the time a restructuring plan is proposed to creditors
- all employee entitlements that are due and payable must be paid by the time a restructuring plan is proposed to creditors
- the board must resolve that it is insolvent or likely to become insolvent at some future time, and that a SBR practitioner should be appointed
- a SBR practitioner oversees the restructuring process, and works with the company to develop the restructuring plan and proposal statement
- creditors are notified
- the restructuring plan is put to creditors for a vote, and
- all debts incurred after the company enters restructuring are not part of the plan and must be paid off outside of the plan.

Section 588GAAB provides that the duty to prevent insolvent trading does not apply to a person and a debt incurred by a company if the debt is incurred:

- during the restructuring of the company, and
- in the ordinary course of the company's business (or otherwise with the consent of the restructuring practitioner or by order of the Court).

60 *Corporations Act 2001* (Cth) s 588GA(1), Note 1.
61 *Corporations Act 2001* (Cth) s 588GWA.
62 Explanatory Memorandum to the Corporations Amendment (Corporate Insolvency Reforms) Bill 2020, p 63.
63 *Corporations Act 2001* (Cth) Schedule 3, item 8, s 500AA.
64 Liability is defined as any liability to pay an admissible debt or claim (see *Corporations Regulations 2001* (Cth), reg 5.3B.03(5) and the definition of 'admissible debt or claim' in reg 5.3B.01; *Corporations Act 2001* (Cth) s 553(1))

Critically, the SBR safe harbour is different to the primary safe harbour provisions in the following ways:

- a restructuring practitioner must be appointed, and must be a registered liquidator
- non-lodgement of taxes and non-payment of employee entitlements do not preclude the appointment of a SBR practitioner, nor the operation of the SBR safe harbour provisions (in each case, provided they are paid by the time a restructuring plan is proposed to creditors)
- creditors are notified, and ipso facto protections apply to impose a moratorium during the planning period, and
- the only consideration in relation to the debts incurred is, as noted above, that the company is restructuring, and that the debt was incurred in the ordinary course of the company's business (or otherwise with the consent of the restructuring practitioner or the Court).

A person seeking to rely on the SBR safe harbour bears a similar evidential burden to that which applies in the primary safe harbour provisions.

5.6 No judicial guidance on safe harbour

There has been little to no judicial guidance on the safe harbour provisions since they came into force.[65] The lack of judicial guidance was cited by stakeholders as a reason for the lack of certainty concerning the operation of the provisions, and underpinned requests for greater guidance throughout the Panel's consultation process.

There is also mixed judicial guidance on the insolvent trading prohibition, which creates an added difficulty for directors who seek to ascertain whether a company is insolvent or approaching insolvency.

65 The Panel notes the decision of the Victorian Supreme Court in *Re Balmz Pty Ltd (in liq)* [2020] VSC 652. Whilst the safe harbour provisions were raised by a party in that case, the Court did not engage in any in-depth consideration of how those provisions are to be interpreted.

PART II
THE IMPACT AND AVAILABILITY OF SAFE HARBOUR

6. General awareness of safe harbour

6.1 Current state of awareness

One dominant theme emerging from the Panel's consultation process was insufficient awareness and understanding of safe harbour provisions among directors and many advisers. Stakeholders submitted that greater education is necessary to bolster directors' awareness of the options available to them when a company is in financial distress.

Stakeholders highlighted that awareness levels differ between large and small companies. Directors of large companies are more likely to have knowledge of safe harbour compared to their counterparts in the SME and medium-sized markets. Even where a director of a large company does not possess particularised knowledge about the safe harbour provisions, their advisers do.

Clearly advisers in the insolvency and restructuring space are likely to know about safe harbour. Whether general commercial advisers have knowledge of safe harbour and the insolvent trading provisions was a little less clear from the submissions received. The accounting bodies – CA ANZ, CPA and IPA – believe their members possess a general awareness of the safe harbour provisions. However, a survey conducted by the Australian Restructuring Insolvency & Turnaround Association (**ARITA**) of its members found that 70 per cent of respondents believed there was limited or no knowledge of safe harbour among accountants and lawyers in the members' referral networks.[66]

The Panel saw a marked difference in responses when it came to awareness of safe harbour among SME directors. The general consensus from our consultations is that there is little interest, awareness, knowledge or uptake of safe harbour in the SME market.

In ARITA's survey of its members, 25 per cent of respondents noted that SME directors did not even know what insolvent trading was.[67] The Panel notes that if directors do not possess an awareness of the underlying insolvent trading provisions, their knowledge of the safe harbour legislative carve-out to those provisions is likely to be even less.

A number of submissions contended that even if there was increased knowledge and awareness among SME directors, the fact that the personal wealth of these SME directors is often heavily intertwined with their company (that is, through personal guarantees and potential personal liability for tax debts) means they are unlikely to seek safe harbour protection. This is because the safe harbour provisions will not protect them from their existing or potential personal liability. Therefore, no matter how much the awareness of these SME directors increases, or no matter how they may be encouraged to seek professional advice early, there is concern that their behaviour may remain unchanged.

Submissions by firms which undertake formal insolvency appointments note that there have been relatively few instances of directors raising safe harbour protection when companies have been placed in liquidation. ARITA asked its members who had been involved in safe harbour engagements how many times safe harbour had been put forward by directors as an argument to protect them from an insolvent trading claim in a subsequent liquidation. Of the 34 respondents, 26 said 'zero times' and 8 said between 'one and 5 times'.[68] ARITA also asked its registered liquidator members how many times safe harbour had been relied on by directors in response to an insolvent trading

66 ARITA submission, p 27 and Appendix A, p 32.
67 ARITA submission, p 10.
68 ARITA submission, Appendix A, p 41.

claim by them in a subsequent liquidation.[69] 59 per cent of respondents to that question said 'never', 14 per cent of respondents said between 'one and 5 times', and one respondent said it had been raised with them '6 to 10 times'.[70]

The Panel also refers to the insolvent trading moratorium that applied during a large part of 2020. The moratorium was described as a 'temporary safe harbour' and was widely publicised. Considering the already low levels of awareness about primary safe harbour provisions, the Panel is concerned that directors may conflate the 2 and not appreciate that the primary safe harbour operates differently. Directors did not have to take any positive steps to receive protection under the moratorium. This is not the case with the primary safe harbour provisions that require directors to substantially meet certain pre-conditions (employee entitlement payment and tax reporting). The safe harbour provisions also require directors to be developing one or more courses of action 'reasonably likely to lead to a better outcome for the company' in order to receive protection.

6.2 Improving awareness

Ultimately, the prohibition on insolvent trading, and the safe harbour carve-out, are intended to encourage and uphold good governance. Education is key to attaining that objective. One of the best initial sources for directors is the corporate regulator, ASIC, which can perform the role of educator as well as enforcer. This can, and should be, supplemented by guidance from ARITA, the Turnaround Management Association (**TMA**), the AICD and other industry bodies, and that is considered further below.

The overwhelming feedback from the Panel's consultation process is that it needs to be easier for directors to find simple, plain English guides on their duties and responsibilities, particularly in relation to their personal liabilities for insolvent trading and the existence of the safe harbour provisions. The private sector can, and does, supplement that education. However, we see enormous benefits for directors and advisers who can access general introductory advice from ASIC and/or another reliable public source.

Submissions support the development of specific user-friendly, plain English safe harbour guides, an update of ASIC's Regulatory Guide 217 to refer to safe harbour, and practical policy guidance from ASIC on the application of the provisions – particularly in the absence of any case law.

We make the following observations about the information which is currently available to directors on the ASIC website:

- ASIC's Regulatory Guide 217, which is a guide on a director's duty to prevent insolvent trading, does not refer to safe harbour. ASIC has informed the Panel that this Regulatory Guide is due to be updated and that it has been awaiting the outcome of this Review before doing so. We strongly support an update to ASIC's Regulatory Guide 217 to reflect not only the prohibition on insolvent trading, but also the safe harbour provisions.
- More generally, the 'For business' page on the ASIC website does not reference restructuring, insolvency or turnaround, containing only a reference to 'Closing your company' (which details the process of deregistration). However, references to 'financial difficulty' can be found on the ASIC website via a link entitled 'Running a company – Company officeholder duties'. ASIC also provides some insolvency guides, including one for directors, which can be found under the 'Regulatory resources' tab. The Panel encourages ASIC to include co-ordinated references to 'financial distress' or 'financial difficulties' on its 'For business' page, with direct links to existing resources and any future safe harbour guides that are developed. This could also be supported by

69 ARITA submission, Appendix A, p 43.
70 ARITA submission Appendix A, p 43.

other government organisations (for example, the ATO) so that messaging to directors is consistent from a public policy perspective.

The AICD/BCA submission[71] encourages ASIC to develop guidance on existing best practice in consultation with industry participants.

The Panel believes it is sensible for a corporate regulator tasked with policing breaches of insolvent trading laws, such as ASIC, to make public its views on the relevant provisions, what conduct may raise alarm bells with regard to insolvent trading and/or which may entitle or disentitle a director to rely on the safe harbour provisions.

The Panel acknowledges that any ASIC guide needs to be qualified as representing ASIC's view. If a court subsequently formed a different view to ASIC, directors will nevertheless be armed with a minimum standard ASIC considers representative of good director behaviour when it comes to insolvent trading (which will necessarily need to address the safe harbour provisions). The provision of this information and educational resources would also be a step toward fostering cultural change and improving good director governance more broadly.

The Panel acknowledges that there can never be an exhaustive list of items to be ticked that satisfy directors' duties. The application of directors' duties to the individual circumstances they face requires an informed commercial judgement of the issues pertinent to their company. Accordingly, the Panel is cautious of any safe harbour guide that is too prescriptive.

Other issues raised by stakeholders include the general lack of knowledge among company directors of 'director fundamentals', including directors' duties (particularly in the twilight zone of insolvency), financial literacy and good governance. Stakeholders consulted during this Review recognise the role of industry bodies, such as the AICD, in promoting director fundamentals to larger corporations. However, not every company director is a member of the AICD. Indeed, it is highly likely most SME directors are not AICD members. As previously discussed, ASIC does provide guidance about directors' duties, but a director would need to be actively looking to find it. With the introduction of the Director Identification Number (a unique identifying number that a director applies for and keeps forever), there may be greater opportunity for information to be disseminated to directors (particularly newly appointed directors) which will assist in promoting ongoing awareness of their obligations.

Although this part of the report has focused primarily on the potential educative role of ASIC as the corporate regulator, stakeholders have commented on the need to increase and reinforce awareness of safe harbour as an informal restructuring tool among a company's external advisers, including external tax and general accountants, general commercial lawyers and business bankers. The Panel notes that guides published by key industry bodies often differ, and so would welcome a best practice guide produced by Treasury following consultation with, and endorsement by, key industry bodies. Such a guide could sit alongside ASIC's guidance, as invaluable information sources for directors and advisers.

71 AICD/BCA submission p 9.

7. Impact of the availability of safe harbour practices

The Panel's consultation process highlighted that the safe harbour provisions are a positive development that improve governance outcomes and deliver real options to directors of listed companies, large companies, and some medium companies. The evidence is less clear that it is a mechanism that directors of SMEs and smaller medium companies access successfully. For those SMEs that fit within the parameters which allow them to take advantage of the SBR reforms adopted earlier this year, the relevance of the primary safe harbour provisions (to the extent they were ever appropriate to such companies) has arguably diminished.

7.1 Impact of safe harbour on directors

a) General observations

The safe harbour was introduced to give directors of viable companies breathing space from insolvent trading laws conditional upon them undertaking a restructuring plan to provide a better outcome for the company. Accordingly, their experience of its impact is key to evaluating whether the safe harbour provisions are working as intended.

From the Panel's consultation process, many professionals are unclear on the workings of the safe harbour provisions as a governance tool and attempt to categorise it as a point-in-time event. The availability of the safe harbour provisions is not a set-and-forget concept. It requires directors to monitor performance and prospects as they pursue the plan, and to continually assess whether (with all the inevitable machinations of a turnaround as it develops) the plan is still reasonably likely to lead to a better outcome for the company. Using this framework mitigates against possible personal liability for directors by enabling them to focus on obtaining a better outcome for their company and encouraging better corporate governance.

In submissions received from the AICD/BCA, TMA and other leading practitioners, there is clear evidence many directors of large and larger medium-sized companies have used the safe harbour framework successfully to guide them through restructuring plans towards a better outcome. The relevant companies avoided voluntary administration or liquidation in most of the examples provided.

Larger companies are more likely to have access to capital, debt and resources sufficient to implement a restructuring plan. Often boards of these companies have sound governance structures, independent non-executive directors and sufficient resources to access lawyers and experienced advisers to assist their restructuring plans and implementation.

More detail on the experience of directors (and advisers) of safe harbour in practice is set out in section 7.3 below. The examples given show (albeit often from the perspective of advisers) that directors are:

- for the most part, engaging with the safe harbour provisions
- in many instances, obtaining advice from appropriately qualified entities (**AQEs**) which leads to better financial forecasts and financial models being produced, and
- seeking to ensure that their tax lodgments are up to date and employee entitlements paid.

Our consultations confirmed that this engagement by directors and advisers with the safe harbour provisions has led to a change in dialogue and emphasis among boards. After dealing with the

gateway issues for whether safe harbour is available, directors have a greater focus on turnaround (rather than just avoiding personal liability). As noted, this change has been experienced particularly in larger companies and/or sophisticated boards.

Some stakeholders raised concerns that some boards faced with financial distress are concerned about a stigma associated with 'safe harbour', as well as potential consequences for the company under its material documents and (if listed) its continuous disclosure obligations. These concerns are addressed more fully in section 8.1 of this Report.

The impact of the availability of the safe harbour on directors of SMEs is considered separately below.

b) Directors of SMEs

In many of the submissions received, it was noted that directors in the SME market are either not aware of, or do not focus on, the legal consequences of trading while insolvent. The reason given is that capitalisation of most SME companies is so entwined with personal guarantees provided to third parties (such as landlords, other creditors or financiers) that the corporate veil offers little protection for such directors.

Accordingly, for many directors of companies in the SME market, their decision making is not driven by concerns of contravening insolvent trading laws. As such, whether they seek protection and guidance from the safe harbour provisions is of little consequence to them. Consultations also highlighted that directors of SMEs are more likely not to meet the pre-conditions of substantially paying employee entitlements and substantially complying with tax lodgments and are less to be able to pay external advisers.

Vantage, in its submission, provided a different viewpoint. In their submission and discussion with the Panel, Vantage confirmed they provided advice to SMEs and gave several examples where they knew (either directly or through third parties) of safe harbour advice being provided in the SME and mid-market. Vantage noted that in the SME market and mid-market, there are a number of individuals performing CRO, CEO, GM, CFO or COO roles (on an interim basis) who provide 'an excellent standalone solution at an appropriate price point'.[72] Vantage's only qualification concerned those they described as micro companies, for which they noted safe harbour advice was less common.[73]

c) Cost implications

The cost of safe harbour and safe harbour advice arose as an issue in the Panel's consultation process, although it appears to be a particular issue in the SME market. Stakeholders confirmed that larger companies are more willing and able to bear not just the cost of AQEs, but also the broader restructuring costs associated with engaging with the safe harbour provisions.

The perception safe harbour advice is costly has been put forward as another reason SME directors have not and will not engage with the provisions. Stakeholders advised that small companies lack the financial capacity to meet the cost of seeking safe harbour advice (even at rates of less than $5,000, as referred to in ARITA's survey)[74] and may not see value in spending any residual cash flow on restructuring. The cost of implementing restructuring may also be prohibitive for small businesses, if for example, it is dependent on downsizing a workforce and making employees redundant.

72 Vantage submission, p 43.
73 Vantage submission, p 5.
74 ARITA Submission, p 30.

7.2 Impact of safe harbour on creditors and employees

a) Creditors

It is difficult to easily summarise creditors' interactions with the safe harbour provisions.

On the one hand, the Panel's consultation process found broad evidence that safe harbour has had a positive impact on creditors.

Wexted noted that 'better outcome' analyses undertaken during their engagements confirmed unsecured creditors and trade suppliers would have received lower returns if an external administrator had been appointed immediately.[75] In many cases this is because equity capital had been available in the course of action, which would not have been available in an insolvency appointment.

Deloitte also submitted that the impact of the safe harbour on creditors was positive, insofar as the overall better outcome was achieved (compared to a course of action which would have appointed an external administrator at the first possible indication of insolvency).[76] The AICD/BCA shared this perspective. In support of their claim that the safe harbour provisions had a generally positive impact on creditors, the AICD/BCA referred to an example of a large agriculture business with 200-300 employees that was facing liquidity challenges but received safe harbour advice from an experienced adviser and the directors were able to maintain the business and sell it as a going concern. They noted that the safe harbour was 'understood and supported by the main creditor, who provided further finance to complete the sale'.[77] Relevantly, participants in that example held the strong view that 'absent safe harbour, the business would have been placed in voluntary administration, with significant loss of employment and shareholder equity, as well as poor returns to creditors.'[78]

On the other hand, stakeholders emphasised the difficult intersection between the safe harbour provisions and Australia's unfair preferences regime.[79] If a creditor is on notice of the solvency concerns faced by a company, certain amounts it receives during that period are capable of being clawed back. Accordingly, there are practical obstacles to engaging too forthrightly with unsecured creditors during safe harbour.

The Australian Institute of Credit Management (**AICM**) submitted that unrelated creditors should be protected from unfair preference claims during the period directors are relying on safe harbour, and commented that the 'mechanisms creditors need to employ to mitigate unfair preference claim risk impact all businesses through reduced availability for repayment arrangements, increased security requirements and reduced access to credit terms.'[80] This in turn can frustrate a business with longer-term viability prospects from being effectively restructured.

The Australian Credit Forum (**ACF**) submitted that there should be a similar moratorium (to the safe harbour) placed on unfair preferences 'and the use of those claims against creditors who are forced to continue to support and provide credit to directors and their company.'[81]

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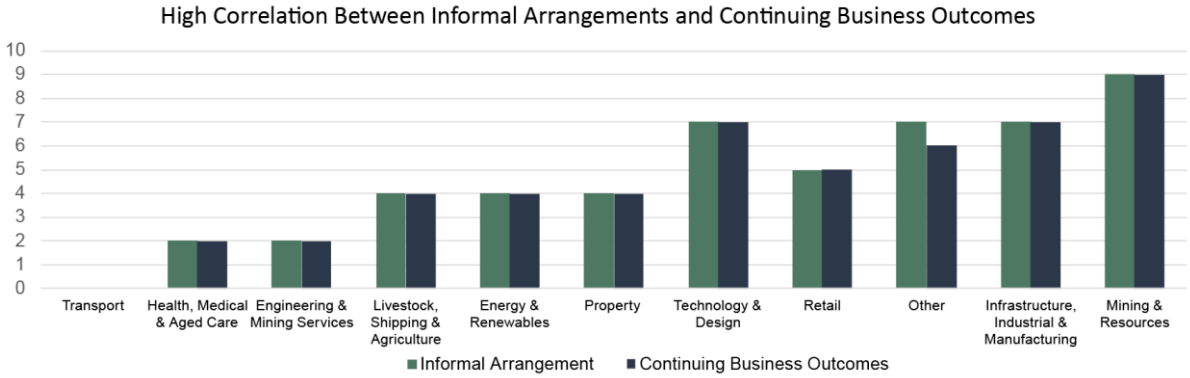
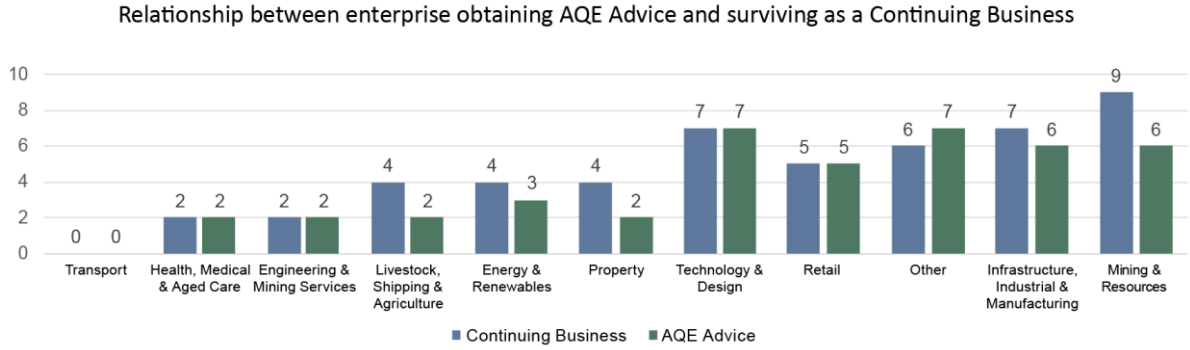
75 Wexted submission, pp 9-10.
76 Deloitte submission, p 4.
77 AICD/BCA submission, p 4.
78 AICD/BCA submission, p 4.
79 An 'unfair preference' is a payment made or other benefit given to a creditor by an insolvent company that causes the creditor to be in a more favourable position than other unsecured creditors in a liquidation.
80 AICM submission, p 2.
81 ACF submission, p 2.

The Panel considers unfair preferences further in section 15.2 of this Report.

The TMA provided helpful graphs to illustrate their members' experience with safe harbour, and the high rate of 'Continuing Business Outcomes' experienced in informal turnarounds.[82] This is relevant to creditors' approach to safe harbour – as a continuing business outcome must, by its nature, involve either creditors being paid in full, or creditors agreeing directly (or via a scheme of arrangement) to a compromise. The TMA provided examples of safe harbour protections resulting in a formal process, but where creditors were still better off (compared to an immediate appointment).[83] The notion of pre-planning formal appointments is considered further in section 7.4 of this Report.





84

Despite this, many creditors (as opposed to advisers) are deeply suspicious of the safe harbour protections provided to directors and are concerned that it has had a prejudicial impact on them. These concerns appear to be borne from the 'information asymmetry' between directors and creditors, as well as the lack of specification and guidance within the provisions.

The ACF submitted the lack of a requirement for directors to advise stakeholders (including creditors) of the implementation of their safe harbour plan would allow 'directors to take a course of action that may be more beneficial to their personal interest than those of the company and its creditors.'[85] In addition, Cole Corporate noted there may be an enhanced risk for creditors who 'legitimately may assume [they are] dealing with a solvent debtor when in fact [they are] not.'[86] The AICM and ACF also considered that the safe harbour provisions had been misused. However, the Panel notes this alleged misuse has not been directly observed or specifically referenced but is based on general suspicions

82 TMA submission, p 5 and Appendix C.
83 TMA submission, p 5 and Appendix C.
84 TMA submission Appendix C.
85 ACF submission, p 2.
86 Cole Corporate submission, p 2.

arising from creditors' concerns with perceived ambiguity of the provisions, and the ability for unregulated advisers to provide safe harbour advice. Allegations of misuse are discussed further in section 7.5 of this Report.

The Panel recognises that there is a general sense of mistrust and anxiety among creditors, and a concern that an influx of insolvencies in the future will demonstrate creditors have been adversely affected. Until and unless such appointments occur (accompanied by evidence of a worsening position of creditors), we think such fears are outweighed by evidence from the submissions of successful safe harbours. The Panel also notes that the circumstances in which creditors never find out about directors accessing safe harbour protection are invariably positive, as the safe harbour has enabled the company to continue to trade, which undoubtedly benefits creditors.

b) Employees

Submissions note that where the safe harbour provisions are used successfully to implement an informal restructure, it is difficult to see how employees would be adversely affected. The preservation of businesses and, therefore, the retention of employees is one of the primary benefits of safe harbour.

Submissions also point to the pre-condition requiring substantial compliance with the payment of employee entitlements as a positive for employees.

Safe Harbour case studies provided in submissions show instances of employment being saved either through the company being restructured or by a sale of the company's business as a going concern. Even where some operational restructuring was required that saw some employees made redundant, the case studies note those employees were paid relevant notice and redundancy provisions.

Some case studies provided by Wexted raised the issue of likely reliance on the Fair Entitlement Guarantee (**FEG**) scheme to fund employee entitlements had the directors moved to an immediate appointment of a voluntary administrator or liquidator.[87]

In the case studies provided by Wexted, the restructure implemented with the protection of the safe harbour provisions, meant there was no call on the FEG scheme.[88] Directors are also incentivised to keep payment of the company's employee entitlements up to date so they can avail themselves of safe harbour protection. This includes superannuation which is the most common employee entitlement not paid in the ordinary course of business. In any subsequent liquidation, if the FEG scheme was called on to pay employee entitlements, any return to the Commonwealth is also less likely to be eroded by significant outstanding superannuation obligations which, while not funded by the FEG scheme, rank equally with outstanding wages in the payment waterfall contained in section 556 of the Act.

c) FEG scheme and Recovery Program

The FEG scheme is administered by the AGD and provides financial assistance to cover certain unpaid employment entitlements to eligible employees who lose their jobs due to the liquidation of a company. The Commonwealth then has the right to stand in the shoes of the employee as a subrogated creditor and claim as a priority creditor in the liquidation.

The FEG Recovery Program is administered by the AGD for the purpose of funding actions by liquidators to recover amounts advanced under the FEG scheme. Between 1 July 2015 to

87 See case studies in Annexures to the Wexted submission.
88 See case studies in Annexures to the Wexted submission.

30 June 2021, $212.29 million was recovered under this Program.[89] Actions funded by the FEG Recovery Program include insolvent trading claims and, therefore, the AGD is a key stakeholder when considering how the underlying insolvent trading prohibitions and related safe harbour provisions should operate.

The interaction between the Commonwealth via the FEG scheme as a priority creditor in any liquidation and the safe harbour provisions, is discussed further in section 14.6 of this Report.

7.3 Success stories

It is clear from the Panel's consultation process that safe harbour is being used by directors. A number of submissions provided us with case studies and details of safe harbour being utilised, which are summarised below.

The ARITA survey of its professional members had 108 responses. Not all questions were answered by all respondents and the following percentages are calculated by reference to the total respondents who answered particular questions. 53 per cent of respondents had been engaged by a client to develop a safe harbour plan or 'better outcome' analysis[90] and 62 per cent of respondents had personally recommended using safe harbour protection since its inception.[91] 76 per cent of respondents said that when they had been engaged as a safe harbour adviser, a successful restructure/turnaround without any form of external administration had been achieved.[92] 40 per cent of respondents said there had been a successful restructure/turnaround through a form of external administration following a safe harbour engagement.[93] 27 per cent of respondents advised that despite the development of the plan, the company they were advising had been placed into liquidation.[94]

ARITA's view is that the safe harbour regime is achieving what it was conceived to deliver – provide breathing space, opportunity and confidence for directors, albeit primarily for larger companies.

Wexted's submission noted it had undertaken over 20 engagements, with most having been ASX-listed companies or significant private companies.[95] Wexted referred to 7 case studies which included examples of securing additional capital, restructuring debt facilities, divestment of non-core assets, operational restructures and negotiating exit strategies with particular stakeholders followed by a solvent wind down. The time required to complete the restructures in the case studies ranged from 5 months to over 12 months.

One of the case studies referred to a publicly listed manufacturing company with over 1,000 employees, high debt levels which had been exacerbated by COVID-19, and significant unsecured creditors including lease liabilities. In an external administration, the better outcome analysis estimated secured creditors would receive approximately 80 cents in the dollar, the potential for over $100 million of employee entitlements would need to be funded by the FEG scheme, no return to unsecured creditors or equity holders and industry disruption with downstream negative impacts on over 1,000 other businesses. The courses of action included undertaking a business review and evaluation, a capital raising, restructuring of debt facilities, implementing cost saving initiatives and negotiating/compromising key creditor claims. The safe harbour provisions resulted in board stability during an uncertain period together with time and security to formulate

89 Fair Entitlements Guarantee Recovery Program Fact Sheet July 2021 (Attorney-General's Department), p 1.
90 See ARITA Question 3 (ARITA submission, Appendix A, p3.
91 See ARITA Question 9 (ARITA submission, Appendix A, p 13.
92 See ARITA Question 14 (ARITA submission, Appendix A, p 19.
93 See ARITA Question 15 (ARITA submission, Appendix A, p 20.
94 See ARITA Question 16 (ARITA submission, Appendix p 21).
95 Wexted submission, p. 9.

and execute the restructure which was undertaken over a period of approximately 12 months. The company continues to trade on the ASX, the jobs of approximately 75 per cent of employees were saved, the secured creditor and unsecured creditors continue to be paid in the ordinary course of business, noteholders converted debt to equity and existing equity was preserved in a diluted form.[96]

Vantage disclosed having undertaken 23 safe harbour engagements encompassing 195 Australian companies and over 5,000 employees. Of these:

- 78 per cent (or 18) were successful with 13 engagements resulting in the associated companies being turned around avoiding insolvency frameworks altogether;
- 5 engagements utilised a voluntary administration, deed of company arrangement (**DOCA**) or scheme of arrangement framework to implement part of the turnaround strategy. Four of those 5 were done under the protection of safe harbour with one not able to meet the employee entitlement payment and tax lodgement pre-conditions; and
- the remaining 5 engagements ultimately saw the companies being placed into liquidation.[97]

Deloitte's submission notes they have participated in over 50 safe harbour engagements nationally.[98] Three case studies were provided which included examples of negotiating a sale of a business, capital raising and negotiating with particular stakeholders to resolve outstanding litigation.[99] The outstanding litigation example resulted from the company receiving a significant adverse judgment debt which exceeded the company's assets.[100] The directors believed there were reasonable prospects of negotiating a more acceptable settlement, but those negotiations were likely to take some time to conclude.[101] The directors used the safe harbour provisions while the negotiations occurred. Those negotiations were ultimately successful, so the company continues to trade with jobs preserved and flow-on distress to other smaller businesses in the supply chain avoided.[102]

The TMA submission included 55 case studies from 20 TMA stakeholders covering engagements that used safe harbour (48) and others that did not (7).[103] The case studies include examples of operational restructures, renegotiating payment terms, other negotiations with particular stakeholders, balance sheet restructures, covenant waivers or rewrites, capital raisings, refinancing, new debt structures and sale and leasebacks of significant assets.[104] Successful restructure without a form of external administration was achieved in 85 per cent of cases, 15 per cent required some form of external administration, typically voluntary administration and only 2 of the 55 case studies resulted in the companies being placed into liquidation.[105] The length of time in the case studies that directors relied on the safe harbour provisions in successful restructures ranged from 2 months to more than 12 months.[106]

One TMA case study refers to a large industrial company with 200 employees and a high costs structure that experienced liquidity problems when customers unexpectedly reduced order volumes.[107] With the benefit of safe harbour protection, the directors pursued a dual track process of

96 Wexted submission, p. 9.
97 Vantage submission pp 6-8.
98 Deloitte submission, p 1.
99 Deloitte submission, p 8.
100 Deloitte submission, p 8.
101 Deloitte submission, p 8.
102 Deloitte submission p 8.
103 TMA submission, pp 3-4; The Panel notes that some of these case studies may also have been included as case studies in other submissions received by the Panel.
104 TMA submission, p 4, footnote 4.
105 TMA submission, p 5.
106 TMA submission, p 5.
107 TMA submission, Appendix B, p 23.

renegotiating loan facilities with a view to refinancing while also running a sale of business process. The loans were successfully refinanced, and the business sold, preserving all 200 jobs.[108]

The case studies illustrate the breadth of issues that companies can face and the myriad solutions that can be canvassed and ultimately used.

7.4 Where safe harbour is followed by a formal appointment

There are 2 main circumstances where a formal appointment follows safe harbour:

- First, where administrators or liquidators are appointed to the company because the restructuring plan has failed or is no longer 'reasonably likely to lead to a better outcome,' or because of other factors (including, for example, evidence of non-compliance with the pre-conditions to access).
- Second, where the restructuring plan itself envisages a formal appointment to give effect to one or more elements of it, and the period prior to that appointment is utilised to plan for a more orderly and efficient appointment.

Both of the above circumstances are, in the Panel's view, acceptable utilisations of the safe harbour provisions.

In respect of the former, the Explanatory Memorandum acknowledges that some companies may not be able to recover and will still proceed to voluntary administration or liquidation despite the directors' best efforts.[109] In respect of the latter circumstance, where companies do enter into particular formal insolvency processes, the safe harbour provisions are aimed at giving those companies a better chance of being turned around or of preserving value for creditors and shareholders.[110]

Consultations have provided either anecdotal evidence or actual case studies which have involved a formal appointment following a period in which directors have been operating under the safe harbour provisions.

References are made in submissions to turnaround plans and restructures that set out to use formal processes as part of the restructures and other examples of where a turnaround plan or restructure has been ultimately unsuccessful which resulted in the directors making the decision to place the company in voluntary administration or liquidation.

ARITA's survey refers to respondents having experience with safe harbour engagements that have resulted in a successful company restructure through a form of external administration subsequent to safe harbour work.[111]

As mentioned above, of the 18 successful restructures included in Vantage's submission, they note all but one was done under safe harbour protection.[112] Five were described as using a formal process to effect a restructure, 4 of which developed and implemented a turnaround plan under safe harbour protection, where one element of the overall turnaround involved a strategic pre-planned voluntary administration or scheme of arrangement to restructure certain but not all group entities.[113]

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108 TMA submission, Appendix B, p 23.
109 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth) [1.21].
110 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth) p 4.
111 ARITA submission, Appendix A p 20.
112 Vantage submission, p 7.
113 Vantage submission, p 7.

Vantage submitted that the safe harbour provisions provide opportunity for any voluntary administration to be well planned, in turn increasing the prospect of the return to creditors being greater than it might otherwise have been.[114]

The Law Council also made reference to the provisions being used effectively to drive better outcomes in formal insolvency processes, in particular by allowing directors time to formulate a DOCA proposal and to engage with creditors (particularly secured creditors) before placing a company into voluntary administration or liquidation.[115] They also reference feedback from insolvency practitioners who say that, even where directors' efforts have been unsuccessful in preventing formal insolvency, the provisions have been used effectively by enabling more efficient transitions into voluntary administration or liquidation resulting in improved returns for creditors.[116]

Wexted referred to the successful use of the safe harbour provisions in tandem with schemes of arrangement and included a case study which showed the safe harbour provisions being used and followed by a solvent wind down via a members' voluntary liquidation.[117] They refer to anecdotal knowledge that the provisions are being used to 'pre-plan' a voluntary administration process, which they see no problem with as long as the restructure through this mechanism proves a better outcome than an immediate appointment.[118]

The TMA's submission referred to examples of restructures that have required utilisation of formal (mostly voluntary administration) processes to, for example, access statutory moratoriums.[119] Even where some companies have ended up in liquidation after utilising safe harbour, contributors to TMA's submission considered that those examples ended up achieving better outcomes than expected via an unplanned insolvency process.[120] The better outcome success of the process came from pre-planning steps preceding appointments, including preparing for necessary court orders, ensuring funding lines were available to maintain the business during post-appointment turnaround and restructure events, and ensuring, amongst other matters, that key stakeholders had negotiated restructuring support agreements.[121] One example referred to a 2-week period during which directors were attempting to negotiate with lenders as also allowing them to place their project on 'care and maintenance' and to set terms of renegotiated contracts, which ultimately the voluntary administrators completed.[122] This was seen as resulting in a better outcome than an immediate appointment.[123] Another example, again where directors were unsuccessful in negotiating with a key stakeholder, saw the directors creating a database of interested buyers during this negotiation period, which was ultimately used by the voluntary administrators to sell the business and assets.[124]

The general consensus from those who addressed this issue is that the safe harbour provisions have assisted in achieving better outcomes in formal appointments than what would have been expected via unplanned insolvency processes.

Interestingly, the TMA observed that the past 18 months have been unprecedented both in terms of public support and liquidity in the market.[125] They contend that liquidity will not be there forever, so predict that some of the better outcomes achieved outside a formal process will most likely require statutory moratorium support in the future, and accordingly more voluntary administrations or

114 Vantage submission, p 16.
115 Law Council submission, pp 1-2.
116 Law Council submission, p 3.
117 Wexted submission, p 11.
118 Wexted submission, p 11.
119 TMA submission, p 5.
120 TMA submission, p 5.
121 TMA submission, p 5, footnote 8.
122 TMA submission, Appendix B, p 9.
123 TMA submission, p 4.
124 TMA submission, Appendix B, p 19.
125 TMA submission, p 6.

schemes of arrangement will be needed to execute strategies developed under safe harbour protection in the lead up to such appointments.[126] Their submission notes that safe harbour does not abrogate voluntary administrations – it provides a runway for directors to plan a turnaround strategy which may well be executed inside or outside a formal process, depending on what needs to be achieved.[127]

Finally, the Panel notes that it is not uncommon to have more than one course of action, whereby directors are pursuing 'Plan A', but also have a 'Plan B, C or D' which (whilst not as optimal a course of action as Plan A), is still reasonably likely to deliver a better outcome for the company than an immediate appointment. In such cases, directors may turn to their 'back up plan' during times that their primary Plan A is less than reasonably likely to succeed. In the Panel's experience (supported through the Panel's consultation process), one of those plans may be a pre-planned appointment. The safe harbour provisions can provide directors with time to shore up the support of secured creditors, enter into an 'implementation deed' or 'restructuring support deed' with key creditors and stakeholders, negotiate standstills, negotiate how best to fund the administration, and, often, to agree the terms of a proposed DOCA with stakeholders. It should be noted that a 'pre-planned' administration is different to a 'pre-packed' administration. The implementation of a 'pre-planned' administration is still subject to creditors' approval, the administrator's due process and the administrator's independence.

The Panel welcomes an interpretation of the safe harbour provisions that is flexible, dynamic and able to be applied in a multitude of circumstances. The Panel is also of the view that an orderly voluntary administration is not always the terrible outcome for companies that many assume it is and cautions against a categorisation of a voluntary administration as akin to 'safe harbour failure'. Clearly, there will be instances of 'safe harbour failure', but that should be determined by reference to what the directors' course of action was, and a failure to achieve that outcome.

7.5 Instances of misuse

In the vast majority of the Panel's consultations, there were no reports of misuse of the safe harbour provisions. In particular, there were no examples of the safe harbour provisions being used for illegal phoenixing purposes.[128] A number of stakeholders commented that illegal phoenixing and safe harbour don't sit easily together – as safe harbour requires a company to have its employee entitlements substantially paid and tax lodgements substantially up to date. If a company is going to 'illegally phoenix', then it will likely do so without satisfying those gateway items. ARITA made the comment that 'abuse of the eligibility requirements would seem to be difficult as they are generally quite binary, and it is not immediately obvious to us what other possible misuses may exist'.[129] The AICD/BCA observed that any perception that the safe harbour provisions provide an incentive for directors to 'make decisions that are reckless or lacking in due care and diligence is not supported by examples and practices shared with the AICD' and would in any event be inconsistent with the general directors' duties contained in sections 180-183 of the Act.[130]

Where misuse was referenced or raised in a written submission or by way of discussions with the Panel, it was as a generic comment, and no evidence was provided to substantiate any claims of misuse.

126 TMA submission, p 6.
127 TMA submission, p 7.
128 Illegal phoenix activity occurs when a new company, for little or no value, continues the business of an existing company that has been liquidated or otherwise abandoned to avoid paying outstanding debts, which can include taxes, creditors and employee entitlements.
129 ARITA submission, p 3.
130 AICD/BCA submission, p 5.

Wexted commented that misuse may arise from advisers implementing a low cost 'checklist' style approach to the legislation, rather than a meaningful analysis,[131] and identified that the risk of that occurring in the SME market was higher (because funds available to pursue an insolvent trading claim may be limited). Whilst there is a tension between accessibility of advice (where cost is a factor) and quality (good advice is often not cheap), ultimately the purpose of the safe harbour provisions is to encourage viable turnarounds. We think it unlikely that a 'tick the box safe harbour' will result in long term viability of a financially distressed business, and in that respect, this should be a risk that is monitored by reference to reports by administrators and liquidators on insolvent trading and safe harbour.

A number of creditor-focused submissions highlighted the lack of transparency in the safe harbour process and were concerned that the lack of transparency increased the risk of misuse. At present, this appears to be a theoretical rather than substantiated risk, borne out of a mistrust for the process, given that it is usually a private process to which creditors are not privy. Clearly, any potential misuse will only come to light where there is a subsequently appointed voluntary administrator or liquidator who investigates what the directors did under the auspices of 'safe harbour'. The Panel refers to section 14.1 of this Report, where we suggest data be collected as part of the general reporting undertaken in formal appointments, so that any safe harbour misuse can be more effectively monitored.

Separately, 'misuse' was also referred to in submissions in the context of the quality of advisers providing safe harbour advice. Those issues are separately addressed in section 9.2 of this Report.

7.6 Impact of safe harbour on enforcement

The 2 parties who can take action against directors in respect of insolvent trading are the appointed liquidator in question and ASIC.

Liquidators need to have funding available to them to undertake their investigations and pursue any consequent legal action. Whilst directors bear the evidentiary burden to establish safe harbour, the liquidator bears the burden of proof in respect of any legal action that follows. That is, the liquidator must show that, on a balance of probabilities, the course(s) of action taken by the directors were not reasonably likely to lead to a better outcome for the company. The Panel is not aware of any such legal proceedings being initiated to date.

The safe harbour provisions add an additional burden to a liquidator to demonstrate a breach of the insolvent trading provisions. The Panel suspects that insolvent trading actions may be more difficult to bring in the future. This is not a suspicion shared by all. ARITA notes that in some respects, the safe harbour provisions may make it easier for liquidators to bring proceedings for insolvent trading, because directors must provide books and records to the liquidator as a pre-condition for protection.[132] This is certainly a fear shared by some stakeholders in their review of the subjective elements of 588GA(1), and that is explored further in section 8.1 of this Report.

131 Wexted submission, p 11.
132 ARITA submission, p 16.

7.7 Impact of the COVID-19 Insolvent trading Moratorium

In March 2020, the Commonwealth introduced a temporary moratorium protecting directors from civil liability for insolvent trading (**Insolvent Trading Moratorium**).[133] The Insolvent Trading Moratorium formed part of a legislative package aimed at providing temporary relief for financially distressed businesses during the COVID-19 pandemic.[134]

Since the commencement of the Insolvent Trading Moratorium (as well as various other COVID-19 stimulus measures and protections afforded to companies), the number of insolvency appointments has substantially declined.[135]

The Insolvent Trading Moratorium was described as providing 'temporary relief for directors from any personal liability for trading while insolvent' and attracted significant media attention.[136] However, the provisions are more narrowly prescribed than that description suggested, as the Moratorium only applied to debts incurred 'in the ordinary course of the company's business'.[137]

The provisions of the Insolvent Trading Moratorium, which was extended until 31 December 2020, are extracted below:

Section 588GAAA safe harbour – temporary relief in response to the coronavirus

Safe harbour

(1) Subsection 588G(2) does not apply in relation to a person and a debt incurred by a company if the debt is incurred:

(a) in the ordinary course of the company's business; and

(b) during:

(i) the 6-month period starting on the day this section commences; or
(ii) any longer period that starts on the day this section commences and that is prescribed by the regulations for the purposes of this subparagraph; and

(c) before any appointment during that period of an administrator, restructuring practitioner or liquidator of the company.

(2) A person who wishes to rely on subsection (1) in a proceeding for, or relating to, a contravention of subsection 588G(2) bears an evidential burden in relation to that matter.

When the safe harbour does not apply

(3) Subsection (1) is taken never to have applied in relation to a person and a debt in the circumstances prescribed by the regulations for the purposes of this subsection.

133 *Coronavirus Economic Response Package Omnibus Act 2020* (Cth); *Corporations Act 2001* (Cth) s 588GAAA.
134 *Coronavirus Economic Response Package Omnibus Act 2020* (Cth).
135 ARITA submission, p 17; See also weekly statistics compiled by ASIC on the ASIC website at: <https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvencystatistics-series-1b-notification-of-companies-entering-external-administration-and-controller-appointmentsweekly/for weekly insolvency statistics compiled by ASIC.>
136 Treasury, Australian Government, Fact Sheet - Economic Response to the Coronavirus, 'Temporary Relief for financially distressed businesses'.
137 *Corporations Act 2001* (Cth) s 588GAAA(1)(a).

a) The impact of the Insolvent Trading Moratorium on director behaviour

As may be expected, the Insolvent Trading Moratorium had a mixed reception among directors, creditors and advisers.[138]

There is anecdotal evidence that some directors of less well-funded or less well-advised companies, including SME directors, viewed the Moratorium as a 'get out of jail free' card. ARITA in their submission noted that members believed the Insolvent Trading Moratorium was used, at least by directors of SMEs, to 'kick the can down the road.'[139]

It also emerged during the Panel's consultation process that safe harbour advisory work reduced dramatically during that period. Accordingly, whilst ARITA noted that 'sophisticated directors of larger enterprises used the Insolvent Trading Moratorium as an opportunity to seek advice to take steps to make safe harbour protection available to them at the end of the moratorium',[140] it was not an approach broadly taken by Australian directors during that period. The correlation between the removal of the 'stick', and the anecdotal drop off in directors receiving advice during that period, is relevant to any consideration of an overhaul of Australia's insolvency regime. It is a correlation that should be further tested (as the circumstances of COVID-19 are not reflective of a normal state).

A number of advisers expressed their surprise that, at the conclusion of the Insolvent Trading Moratorium, their formal insolvency appointments did not increase. Some advisers considered the Moratorium was only one factor that contributed to directors continuing to trade during the pandemic. Other factors included government stimulus payments, ATO inactivity, restrictions on the normal statutory demand process, lender forbearance, JobKeeper, the SME Loan Guarantee Scheme and changes to leasing codes.

A number of individuals and industry groups are fearful that the Insolvent Trading Moratorium, combined with other liquidity support measures, mean that Australian companies have not yet experienced the full economic consequences of COVID-19 from an insolvency perspective, and that many companies are continuing to trade despite underlying financial distress.[141] Much of this is summation and conjecture: there is insubstantial data available on the current broad economic health of Australia's corporations, and whether there is, indeed, an increase in 'zombie companies.' Whether or not this fear is well-founded will only be revealed once creditor enforcement action resumes and external administrations are 'forced' on companies.

Consultations undertaken by the Panel revealed a widely shared belief that the Insolvent Trading Moratorium provisions were simpler and more accessible for directors than the primary safe harbour provisions. Notably, the reference in the Moratorium provisions to debts incurred in the 'ordinary course of … business' is language that is readily understood by company directors, who would therefore have greater confidence that their actions would fall within the parameters of the safe harbour. Conversely, the primary safe harbour provisions do not refer to debts incurred in the 'ordinary course of … business'. The absence of a reference to 'ordinary course of business' debts has been cause for concern among some and is explored further in section 8.4 of this Report.

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138 CA ANZ and CPA noted in their submission that the insolvent trading moratorium and inactivity by the ATO contributed to 'directors delaying action to address any solvency concerns' (CA ANZ / CPA submission, p 4). ACF considered that the moratorium 'had a negative impact on the interests of creditors and employees overall' because it 'resulted in a delay to the ordinary business life cycle process which is still yet to be fully played out.' (ACF submission, p 3).

139 ARITA submission, p 3.

140 ARITA submission, p 3.

141 ARITA's submission noted the significant decline in the number of insolvency appointments and that the ATO has 'not recommenced recovery actions for debt and lenders are still largely not taking enforcement action'. (ARITA submission, pp 17-18).

b) The interaction of the Insolvent Trading Moratorium and the primary safe harbour provisions

Two key (and somewhat contradictory) perspectives arose from advisers during the Panel's consultation process.

- In the first instance, many advisers observed that the Insolvent Trading Moratorium essentially negated the need for the primary safe harbour provisions during that time.[142] They further reported that safe harbour work decreased and, accordingly, there was an absence or dearth of data available from which to analyse the impact of the primary safe harbour provisions and how they would have been able to assist companies during the pandemic.[143]
- Others observed that many advisers viewed the Insolvent Trading Moratorium as only available if a company completed its turnaround during the Moratorium period or otherwise entered into formal insolvency proceedings prior to the expiry of that period. These advisers, therefore, believed directors needed to continue to engage with the primary safe harbour provisions in order to have a 'back up protection'.[144]

It emerged in the Panel's consultations that directors who continued to engage with the primary safe harbour provisions were from larger and listed entities.

7.8 Effectiveness of the insolvent trading prohibition

Some stakeholders believe that the insolvent trading prohibition in section 588G is ineffective, particularly at the SME level, pointing to ASIC statistics on insolvent trading allegations in support of this belief. A review of these statistics shows allegations of insolvent trading by liquidators in 41 per cent of section 533(1) reports in 2008-9, increasing year on year through to 71 per cent of reports in 2018-19. The way liquidators report to ASIC changed in March 2020. ASIC provided the Panel with statistics for subsequent years that have not yet been made public due to the change in reporting methods. Based on this preliminary, unpublished data, it appears the year-on-year increase continued into the 2019-20 year, but there was a decrease in the percentage of reported allegations of insolvent trading in the 2020-21 year. This may have had something to do with the Insolvent Trading Moratorium and we are not sure a conclusion about instances of insolvent trading allegations decreasing should be drawn from 2020-21 statistics.[145]

We are cautious about assessing the impact of safe harbour on the underlying effectiveness of the insolvent trading prohibition by reference to non-contextualised statistics. For example, it would be desirable to assess that data against other metrics, including increases to the average number of companies incorporated during those periods, improved reporting by liquidators and assessment of how many insolvent trading claims were pursued.

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142 ARITA, in their submission, took the view that the Insolvent Trading Moratorium (in conjunction with various government stimulus packages and related COVID-19 initiatives for distressed businesses) 'significantly reduced the demand for and the uptake of safe harbour, particularly in the SME sector where directors have less knowledge of safe harbour and will accordingly not have taken the opportunity to plan ahead and implement safe harbour strategies.' (ARITA submission, p 9)

143 For example, both KPMG and the Law Council noted that the Insolvent Trading Moratorium reduced the requirement for directors to seek safe harbour advice and utilise safe harbour provisions as they were already protected (KPMG submission, p 3; Law Council submission, p 4).

144 For example, McGrathNicol noted the controversy around whether the Insolvent Trading Moratorium applies if a company did not appoint an EXAD prior to 31 December (McGrathNicol submission, p 5).

145 ASIC has advised that on further review the preliminary analysis may be subject to change before it is published.

7.9 Entrepreneurship

A stated purpose of the safe harbour reforms was to promote a culture of entrepreneurship and innovation to help drive business growth, local jobs and global success.

The safe harbour provisions were introduced to drive cultural change by encouraging directors to keep control of their company, engage early with possible insolvency and take reasonable risks to facilitate the company's recovery (instead of placing the company prematurely into voluntary administration or liquidation). This was expected to promote the preservation of enterprise value for companies, their employees and creditors, reduce the stigma of failure associated with insolvency and encourage a culture of entrepreneurship and innovation. The reforms were also intended to encourage businesspeople with the right skills, expertise and experience to serve as company directors without being deterred by personal liability for the company's debts.[146] For example, by addressing concerns about inadvertent breaches of insolvent trading laws which were discouraging early stage (angel) investors and professional directors from becoming involved in start-up companies.

Whether the reforms have achieved their aims of promoting innovation and entrepreneurship in the 4 years since their inception is hard to measure.

To the extent that the policy to encourage a culture of entrepreneurship was focused on start-ups, we query whether the safe harbour provisions would apply to many in practice, and whether the prohibitions on insolvent trading act as a deterrent to entrepreneurs starting a business. The Panel has received no evidence of what drives the economic risk-taking and investments of entrepreneurs in these circumstances, and further research and analysis is needed (in a broader economic context and in an individual investment context) as to whether the insolvent trading prohibitions are a relevant consideration (or any way linked to the stigma of failure).

We also note that start-up companies are commonly capital deficient and have not, and will not for some time, turn a profit. While the Explanatory Memorandum uses an example of the directors of a start-up company relying on safe harbour, we do query whether the financial position of a start-up may make it very difficult to satisfy the 'reasonably likely to lead to a better outcome' test.

The observations of safe harbour in practice that emerged from the Panel's consultation process (as set out in section 7 of this Report) indicate that directors of existing large and medium-sized companies appear to be taking informed risks and attempting restructures. From the submissions received, such behaviour has the effect, in many circumstances, of improving the businesses on a 'net present value' basis (which arguably is an indicator of entrepreneurism). Previously, directors (particularly professional or non-executive directors) may not have had the appetite for such risk when they bore personal responsibility for its failure.

Wexted's submission also provides anecdotal evidence of incoming directors taking comfort in the safe harbour provisions when accepting an appointment as a director.[147]

146 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth) p 3.

147 Wexted submission, p 6 and Appendix B.

PART III
LEGISLATIVE CONSIDERATIONS

8. Analysis of Section 588GA(1)

8.1 Subjectivity of awareness

Two submissions raised concerns with the subjective element of section 588GA(1).[148]

Section 588GA(1)(a) provides that the safe harbour provisions can be enlivened where:

> *at a particular time after **the person starts to suspect** the company **may become or** be insolvent, the person starts developing one or more courses of action that are reasonably likely to lead to a better outcome for the company*

It is important to understand the broader legislative framework in which that sub-section sits. As previously noted, section 588GA(1) provides a carve-out to the operation of section 588G. The relevant parts of section 588G are:

Section 588G – Director's duty to prevent insolvent trading by company

(1) This section applies if:

(a) a person is a director of a company at the time when the company incurs a debt; and

(b) the company **is insolvent at that time**, or **becomes insolvent by incurring that debt**, or by incurring at that time debts including that debt; and

(c) at that time, there are **reasonable grounds for suspecting** that the company **is insolvent**, or **would so become insolvent**, as the case may be; and

(d) that time is at or after the commencement of this Act.

(2) By failing to prevent the company from incurring the debt, the person contravenes this section if:

(a) the person **is aware** at that time that there are such grounds **for so suspecting**; or

(b) a reasonable person in a like position in a company in the company's circumstances would be so aware.

The concerns in respect of the subjective nature of section 588GA(1) centre around the use of the words '*the person starts to suspect*' in sub-paragraph (a). The reasons for the concern varied between the submissions, and can be summarised as follows.

a) Safe harbour stigma and reluctant directors

There were some reports that directors and their advisers are concerned that, in formally linking safe harbour to a subjective suspicion of insolvency, directors are making it easier for a future liquidator to prove the suspicion requirement under section 588G(2). This concern led to feedback during round table discussions that some directors have been reluctant to engage the safe harbour provisions for fear of admitting the company is insolvent.

That reluctance can be juxtaposed with the views that:

148 TMA submission, p 14; McGrathNicol submission, p 8.

- advisers want directors to engage early with the prospect of insolvency and, therefore, the words 'start to suspect' and 'may' allow for directors to realise that they don't need to wait to engage the safe harbour provisions, and
- some advisers and directors wanted more certainty about when safe harbour began, and used the subjective element of 588GA(1) as a reason to minute their concerns (and, therefore, create the records to support their evidentiary burden).[149]

The Panel does not agree that enlivening the safe harbour provisions, of itself, amounts to an admission of a breach of section 588G. The words between the 2 sections are importantly different: the prohibition on insolvent trading set out in section 588G refers to a company being insolvent or becoming insolvent as a consequence of the relevant debt incurred. That is, a liquidator needs to prove actual insolvency at the time the debt was incurred (or consequent upon the debt being incurred). Likewise, the subjective and objective components of section 588GA(2) require a director (or, as applicable, the 'reasonable person in a like position') to be aware that the company **is** insolvent or **would so become** insolvent.

While there are likely to be instances of directors only seeking to engage the safe harbour provisions after the company is already insolvent, the subjective element of section 588GA doesn't change the underlying application of sections 588G(1) and (2).

However, we are concerned by the feedback that the reference to subjectivity in the provisions somehow increases or creates a negative view of safe harbour or supports a finding that in order to obtain safe harbour protection, directors must somehow formally resolve to do so.

The Panel is of the view that the safe harbour provisions work flexibly and don't require formal resolutions or 'start dates' to apply. We see great benefit in directors seeking early access to appropriately qualified advisers, and developing alternative courses of actions. We also recognise that directors should be encouraged to document their safe harbour deliberations.

Accordingly, the Panel recommends amending section 588GA(1) to refer to financial distress (in addition to the prospect of insolvency). As noted in section 5.1(e) of this Report, the concept of insolvency is a difficult one for directors to engage with, and a concept of financial distress for which they are seeking assistance, may be more palatable to (and understood by) directors. Of course, the test for insolvent trading would still be the existence of insolvency. However, that doesn't need to be the prompt for safe harbour protection and may reduce the disclosure concerns and the 'inadvertent admission' concerns.

b) ASX disclosure

ASX has clearly stated that 'the fact that an entity's directors are relying on the insolvent trading safe harbour to develop a course of action that may lead to a better outcome for the entity than an insolvent administration, in and of itself, is not something that ASX would generally require an entity to disclose under Listing Rule 3.1'.[150] In addition, the ASX has acknowledged that 'most investors would expect directors of an entity in financial difficulty to be considering whether there is a better alternative for the entity and its stakeholders than an insolvent administration', noting that '[t]he fact that they are doing so is not likely to require disclosure unless it ceases to be confidential or a definitive course of action has been determined.'[151]

149 Deloitte submission, p 6.
150 ASX Listing Rules, Guidance Note 8, p 42.
151 ASX Listing Rules, Guidance Note 8, p 42.

However, in some written submissions and during round table discussions, feedback was provided that the spectre of ASX continuous disclosure obligations in the context of the safe harbour provisions continues to be a source of angst and concern for directors in practice.

The prompt for continuous disclosure is, as the ASX has made clear, the underlying circumstances that are leading to solvency concerns. Separately, if a board of a listed company forms the view that the company is insolvent, or will become insolvent, then similarly, that should require disclosure to the market.

However, if linking 588GA(1) to a suspicion of financial distress rather than insolvency enables listed companies to more actively engage in pre-appointment turnarounds, and to better understand their continuous disclosure obligations in that context, then the Panel's view is that would be a positive development.

c) Events of default and termination rights under material documents

Another concern that arose during the Panel's consultation process related to reports of a developing trend that financiers (and in some instances, key suppliers) are including specific defaults and/or review events in their agreements with companies, that are triggered by a director engaging the safe harbour provisions.

This has led to a reluctance by directors to 'form the suspicion' or otherwise formally engage the safe harbour provisions, because to do so would trigger acceleration rights and termination rights by key financiers and creditors.

This is a concerning development and runs contrary to the public policy behind the safe harbour provisions. While a company in financial distress may already be liaising with its financiers and/or key creditors, this will not be true in all instances. It also has the potential to impact disclosure for ASX-listed entities (because if enlivening the safe harbour provisions constitutes a default or review event under a finance agreement or a material contract, that may very well require separate market disclosure). Obviously, any public announcement of safe harbour may undermine the course(s) of action the directors are seeking to undertake and, therefore, defeat one of the key purposes of the safe harbour provisions.

We are not convinced that removing the subjective element of section 588GA cures such a quandary (as presumably, any contractual provision may then turn to the appointment of an AQE as a trigger, for example). Two other potential ways to deal with this concern are set out below. However, the Panel has concerns with each of them, and is reluctant to recommend either on a standalone basis without further consultation, given the effect they could have on creditors, and their potential to heighten misuse:

- ipso facto provisions[152] could be extended to such 'safe harbour' specific defaults / review rights (to the extent they don't already). However, we note that such a development would need to be considered carefully, together with a review of unfair preferences, to ensure that creditors are not unfairly prejudiced, and the application of the ipso facto provisions in such circumstances does not encourage safe harbour misuse. For example, an outcome that could see a creditor forced to trade with a company in financial distress where its exposure increases during that time, is a different scenario to where it is forced to trade with an administrator during the same period (and where the administrator usually has personal liability for the debts incurred).

152 Ipso facto provisions apply to (non-excluded) agreements, contracts and arrangements entered into after July 2018 and give protection against termination rights arising out of certain corporate restructuring and insolvency procedures.

- any provision in a contract, agreement or arrangement that provides that a director seeking to rely on safe harbour:
  - is required to notify a third party of such reliance, or
  - is of itself, a separate event of default or termination event or review event,

  be considered unenforceable from a public policy perspective. For the avoidance of doubt (and similar to the ipso facto provisions) this would need to make clear that it did not extend to other defaults or termination rights (for example, payment defaults).

8.2 Reasonably likely test

There continues to be confusion in practice about the meaning of the term 'reasonably likely'. It is the Panel's experience that directors struggle to understand what this means, and advisers play a critical role in explaining this to them.

At least one written submission noted, and this point was also raised in round-table discussions, that the general market understanding of the term 'reasonably likely' is 'more likely than not'.[153] However, such a definition is inconsistent with the background provided in the Explanatory Memorandum, which notes, among other matters, the following in relation to whether a course of action is 'reasonably likely' to lead to a better outcome:

- that it 'does not require a better than 50 per cent chance of a better outcome than the immediate appointment of an administrator or liquidator'; rather, it requires the chance of achieving that outcome to be 'fair', 'sufficient' or 'worth noting', as opposed to 'fanciful or remote'; what constitutes a course of action which is reasonably likely to lead to a better outcome 'will vary on a case-by-case basis depending on the individual company and its circumstances at the time the decision is made'
- some directors may consider and then 'discard' several different options when deciding on a course of action. Of those available options, only some may be reasonably likely to lead to a better outcome for the company. It may also be necessary for adjustments to be made to a course of action to ensure it remains reasonably likely to lead to a better outcome (for example, the pursuit of a new course of action or the appointment of an administrator or liquidator)
- directors who take a 'passive approach' to the company's situation, who allow the company to continue trading 'as usual' despite severe financial difficulty, or who devise recovery plans which are 'fanciful' will not be eligible for safe harbour protection. Similarly, safe harbour protection will not extend to directors who fail to pursue and implement a course of action or who fail to appoint an administrator or liquidator within a reasonable timeframe once it becomes clear that the restructuring plan has failed (and there is no other course of action that satisfies the requirements of 588GA)
- if a proceeding is ultimately brought under section 588G(2), a director who wishes to rely on safe harbour protection bears an 'evidentiary burden' in relation to the matters in section 588GA(1). This means the director must, among other things, adduce or point to evidence which suggests a 'reasonable possibility' that the course of action pursued was reasonably likely to lead to a better outcome, and

153 Deloitte submission, p 6.

- directors must be able to point to evidence to assist with meeting that evidentiary burden – a 'mere statement' that the course of action developed or undertaken would be reasonably likely to lead to a better outcome would not suffice.[154]

While the Panel is not aware of instances where a misconception of the term 'reasonably likely' has led to a premature appointment, we note there is a real risk that it may. The content of the Explanatory Memorandum, and the nuance that it provides, is not readily accessible to many directors and advisers, and is another reason why an easily accessible guide to the key safe harbour provisions is plainly needed.[155] The Panel would prefer to address interpretation concerns through such guidance, rather than amending the reference to 'reasonably likely' in the provision.

A number of submissions received by the Panel[156] referred to the possibility of applying the 'business judgment rule' contained in section 180(2) of the Act, or something like it, to the prohibition on insolvent trading. For example, by incorporating the safe harbour provisions into the existing business judgment rule, with a view to integrating the safe harbour carve-out to the duty to prevent insolvent trading with the general directors' duties in Part 2D.1 of the Act. King & Wood Mallesons submitted this could involve the 'reasonably likely' test in section 588GA(1) being replaced with 'something more akin to the rational belief test' found in section 180(2)(d).[157]

A reframing (or wholesale replacement) of the safe harbour provisions in favour of the approach adopted for the business judgment rule would have flow-on consequences for the insolvent trading regime in the Act. Section 588G is framed as a 'default contravention' which focuses on when debts are incurred by a company, rather than a director's *conduct* in incurring that debt.[158] The introduction of a 'rational belief' element would shift the objective focus of the 'reasonably likely' assessment in section 588GA(1), to a more subjective analysis necessarily involving the assessment of a director's state of mind. For this, and other reasons outlined in section 15 below, the Panel considers this is a matter more appropriately dealt with as part of a holistic review of Australia's insolvency laws.

8.3 Better outcome analysis

The concept of a 'better outcome', and how it informs the approach taken by directors (and their advisers) when seeking to rely on the safe harbour, was addressed often throughout the Panel's consultation process. This is not surprising, given the touchstone for engagement of the safe harbour provisions is whether, after starting to suspect a company may be or become insolvent, a director starts developing one or more courses of action that are reasonably likely to lead to a 'better outcome' for the company.

Section 588GA(7) defines better outcome as 'an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, of the company' (being, for the purposes of this report, the **better outcome analysis**). Many submissions queried what this means; is it just a better outcome for the company, or are other stakeholders also relevant?

154 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.18], [1.19], [1.44], [1.52], [1.58], [1.75] and [1.76].
155 See section 6.2 of this Report.
156 See, for example, the submissions from Cole Corporate, the Law Council, ARITA, Wellard, King & Wood Mallesons and the TMA.
157 King & Wood Mallesons submission, pp 4-5.
158 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.6]. See also the discussion in section 5.1(c) of this Report concerning the 'reasonable grounds to suspect' element of section 588G(1).

Definition of better outcome

The definition of better outcome is supported by the factors in section 588GA(2) which are intended to provide further guidance to directors when assessing whether a course of action is reasonably likely to lead to a better outcome.[159] These factors are 'indicative and non-exhaustive',[160] to recognise that the approach which is reasonably likely to lead to a better outcome for a company will vary depending on the company's individual circumstances and the situation faced by directors at the point in time they formulate a particular course of action.[161]

For these reasons, what represents a better outcome for a company for the purpose of engaging the safe harbour is fact-dependent and difficult to prescribe. Sections 588GA(2) and 588GA(7) provide some assistance in this regard. However, the analysis of whether a course of action is reasonably likely to lead to a better outcome requires directors to, among other things:

- proactively engage in an assessment of what course(s) of action may be available to the company and the likelihood of them being achieved – this analysis requires directors to consider and inform themselves of the company's management and financial position, including its compliance with various legal and regulatory obligations and its relationships with creditors and other key stakeholders
- accommodate what are often complex, dynamic and uncertain circumstances in their decision-making processes, meaning a range of options may be considered and discarded when settling on or revising a course of action, a point acknowledged in the Explanatory Memorandum,[162] and
- continually assess the course(s) of action being pursued in light of the relevant counterfactual, of whether their plan is reasonably likely to lead to a better outcome for the company than the immediate appointment of an administrator or liquidator – for example, directors may be faced with options to either continue trading (and, thereby continue depleting the company's available cash reserves) in pursuit of a turnaround strategy, or to appoint an administrator or liquidator when funds are still available to enable those processes to be undertaken in a more timely and orderly manner.

The safe harbour provisions aim to 'strike a better balance' between protecting creditors and encouraging directors to 'innovate and take reasonable risks'.[163] In the context of the better outcome analysis, this balancing exercise involves the interaction of various factors affecting a director's ability and appetite to undertake a particular course of action, including:

- the expectation that directors continue to comply with their general duties to the company when invoking the safe harbour – this includes the duty to exercise their powers and exercise their duties in good faith in the best interests of the company and for a proper purpose[164]

159 The Explanatory Memorandum notes that the factors in section 588GA(2) may be considered by a court in proceedings where 'the safe harbour is at issue': Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.65].

160 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.61].

161 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.18] and [1.61].

162 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.18].

163 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.12].

164 *Corporations Act 2001* (Cth) s 181; Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.64] and [1.78].

- that, when a company is insolvent or nearing insolvency, a director must take the interests of company's creditors into account as part of complying with their general duty to act in the best interests of the company
- the viability of engaging with the safe harbour process, which may depend on the nature of the industry within which the company operates, and
- in circumstances where turnaround efforts are unsuccessful, the need to have regard to and promote, to the extent possible, the object of Part 5.3A of the Act, which is to provide for the administration of the business, property and affairs of an insolvent company in a way that:
  - maximises the chances of the company, or as much as possible of its business, continuing in existence, or
  - if it is not possible for the company or its business to continue in existence —results in a better return for the company's creditors and members than would result from an immediate winding up of the company.[165]

The question is how the better outcome analysis in section 588GA(1)(a) is operating in practice. Overall, and subject to some submissions calling for more holistic corporate governance reform (discussed further in section 15), there appears to be general support for its inclusion in the safe harbour provisions. Some of the main concerns and suggestions for improvement raised with the Panel are outlined in further detail below. They focused mainly on the lack of clarity concerning the meaning of a better outcome, in light of the 'guiding' (rather than prescriptive) nature of the factors in section 588GA(2),[166] and the lack of judicial consideration of section 588GA.

Nature of the analysis – qualitative and/or quantitative

Several parties queried whether the better outcome analysis was intended to be purely quantitative in nature, or whether it necessarily requires consideration of qualitative factors. A quantitative analysis focuses on the return to creditors under both scenarios, whereas a qualitative analysis also takes into account other factors such as the ability of the company to continue to trade.[167]

For example:

- the Law Council noted it was unclear whether the concept of a 'better outcome' involved a quantitative analysis of whether creditors would obtain a greater return via the successful invocation of the safe harbour provisions, as compared to in an administration or liquidation (and if so, there is a question as to how the 'counterfactual benchmarking return' is calculated), or whether it also involved consideration of qualitative factors such maintaining enterprise and goodwill value through the avoidance of formal appointments[168]

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165 *Corporations Act 2001* (Cth), s 435A.

166 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.65].

167 Macaire Bromley notes relevant qualitative information may include the position of secured creditors, employees and general creditors (such as retention compared with loss of employment, the opportunity for ongoing trade and repayment under plans), going concern considerations (including goodwill, market reputation and any potential loss of key contracts or customers), forced sale implications, ability to access short-term working capital and refinance opportunities, the crystallisation of material liabilities or damages claims (for example, under employment contracts, leases and key supplier contracts), key stakeholder support (whether it is forthcoming consensually as opposed to the impact of insolvency moratoriums) and execution risk, time delay and transaction costs (including administrator or liquidator costs): see Bromley, M 'Safe harbour: a best practice guide for directors' (2021) Practical Law ANZ Practice Notes (Reproduced from Practical Law Australia with the permission of the publishers. For further information, visit www.practicallaw.com.)

168 Law Council submission, p 7.

- Vantage submitted, based on its industry experience, that the better outcome analysis is utilised most effectively when it leverages both quantitative and qualitative data[169]
- Deloitte highlighted that while adoption of a quantitative analysis is compelling having regard to the counterfactual prescribed in section 588GA(7), there are also compelling qualitative factors for directors to consider. Deloitte posed the question: 'what if a liquidation achieved a higher return than a restructuring, but the restructuring allowed the economic entity to continue to trade, support its suppliers with continuing business and provide employment?'[170]

The Panel agrees that the concept of a better outcome involves consideration of both quantitative and qualitative factors. To focus solely on quantitative factors would unduly narrow directors' assessment of the courses of action available to a company. The Explanatory Memorandum makes it clear that, when formulating and assessing the viability of a course of action, directors are expected to investigate and remain informed of a range of matters affecting a company's operations and management. This is consistent with the level of diligence and rigour expected of directors generally, as well as what is expected in order for directors to continue to comply with their general directors' duties.

However, those quantitative and qualitative assessments need to be considered in the circumstance of each company and weighed accordingly. The weight that is given to each will differ depending on the circumstances, but while the overall return to creditors is a significant factor, it is not the only factor and would also not appear to reflect how directors are engaging in this assessment in practice. For example, one participant in the Panel's consultation process noted that while directors engaging in the better outcome analysis may initially default to consideration of financial returns when exploring potential turnaround strategies, they will inevitably (and necessarily) turn their minds to broader factors such as preserving jobs and supply relationships.

Prescribed counterfactual – administration and liquidation, or just liquidation

Of relevance to the submissions made concerning the nature of the better outcome analysis is the counterfactual prescribed in section 588GA(7), being the immediate appointment of an administrator or liquidator. Several parties linked the perceived lack of clarity or confusion regarding the meaning of a better outcome to directors being required to compare the potential outcomes of their turnaround plans with an administration or liquidation scenario.

- ARITA noted that best outcomes for a liquidation or administration scenario were relatively clear (particularly in light of the stated object of Part 5.3A of the Act), but the concept of a better outcome for the purpose of Safe Harbour is less clear.[171] ARITA submitted that directors undertaking the better outcome analysis are faced with a difficult task, given a company's creditors would form differing views on what that outcome entailed.[172] Accordingly, ARITA suggested that 'the reference point for what is a 'better outcome' ought to be expressly stated in section 588GA of the Act, with reference to the continued existence of the company or its business or otherwise the achievement of a better financial return for creditors'.[173] In their view, this would align the better outcome in section 588GA(1)(a) with the object of Part 5.3A of the Act, which necessarily informs the conduct of the formal insolvency processes referred to in the counterfactual in section 588GA(7).[174]

169 Vantage submission, p 40.
170 Deloitte submission, p 6.
171 ARITA submission, p 34.
172 ARITA submission, p 34.
173 ARITA submission, p 34.
174 ARITA submission, p 34.

- King & Wood Mallesons submitted that the counterfactual should refer only to the immediate appointment of a liquidator (rather than an administrator and a liquidator), but they also submitted that the provision should be more closely aligned with the object of Part 5.3A of the Act.[175]
- Vantage noted that the source of confusion may be that the prescribed counterfactual encompasses several outcomes, in particular in an administration scenario where creditors may vote for the company to be wound up (ultimately leading to the same outcome as a liquidation), or consider a proposal for a DOCA (which may require consideration of additional factors including potential delays and execution risks).[176] Vantage emphasised that an administration outcome via a DOCA arrangement would only need to be considered by directors 'where there is a genuine DOCA proposal being canvassed that is a real and viable option'.[177]
- In various round-table discussions, it was noted by some stakeholders that a liquidation scenario may be a more appropriate comparator for the purpose of the safe harbour given its more obvious link to insolvent trading and the liability imposed on directors in section 588G.

The Panel is concerned by the prospect of limiting a counterfactual to only liquidation, as it opens the potential for misuse. Imagine a large company that has unsecured corporate bonds on issue and faces financial distress. The directors seek advice from various qualified advisers, one of whom provides it with a better outcome analysis based only on a liquidation counterfactual that sees the unsecured corporate bond holders paid 20 cents in the dollar. At that time, the board's course of action is to continue to trade while negotiating a long-term standstill for its lenders, together with other debt raisings. While the directors are pursuing that plan, the bond holders provide the company with a detailed proposal of a debt for equity swap (where all other creditors are kept whole), to be achieved through an administration and a DOCA. If the prospects of the DOCA being adopted and effectuated are reasonable (that is, if voting in favour of the DOCA is likely), then surely it is that counterfactual that should be relevant in determining whether the directors' plan is reasonably likely to lead to a better outcome for the company. To compare it to liquidation only is to ignore a key input for value realisation.

However, the Panel is also concerned with linking a better outcome too expressly to the objects of Part 5.3A. The motherhood statements contained at the start of Part 5.3A are clearly important and shape much of the policy and framework behind voluntary administration, but ultimately under Part 5.3A the implementation of those objects is via an independent administrator, and (in the context of a DOCA at least) is subject to the vote of the affected creditors. Caution must be applied in allowing directors (who usually and naturally wish to retain control of the company) to determine a better outcome by reference solely to the business continuing and without regard to what creditors may achieve via an administration.

Notwithstanding the potential options available to a director, the protection of the safe harbour extends to a course of action that is reasonably likely to lead to a better outcome for the company. The Explanatory Memorandum notes this 'requires that there is a chance of achieving a better outcome that is not fanciful or remote, but is 'fair', 'sufficient' or 'worth noting'.'[178] As such, the necessary comparator for the purposes of the counterfactual is an administration or liquidation scenario which is fair and reasonable taking the company's circumstances – when engaging in this comparison, a director is not required to canvass a myriad of theoretical scenarios which have only remote prospects of eventuating. Rather, the focus must be on a counterfactual which has a real,

175 King & Wood Mallesons submission, p 5.
176 Vantage submission, p 15.
177 Vantage submission, p 15.
178 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.52].

and not remote, prospect of eventuating, as Vantage submitted using the example of a DOCA proposal in an administration scenario.

The Panel does not recommend any amendments be made to section 588GA(7). We consider that the appropriate counterfactual will depend on the circumstances the company is facing and, accordingly, the definition of better outcome needs to be flexible enough to accommodate a range of scenarios. The inclusion of both administration and liquidation scenarios provides such flexibility. Furthermore, a more prescriptive counterfactual is likely to create inflexibility and heighten risk of misuse.

Interests of key stakeholders

Another issue raised during the Panel's consultation process was how the interests of key stakeholders are factored into the better outcome analysis, and whether certain stakeholders' interests should be prioritised in that assessment.

ARITA submitted that whilst the better outcome analysis does not expressly refer to the interests of any specific stakeholders, it is implicit that a better outcome for the company than the immediate appointment of an administrator or liquidator would also deliver a better outcome for creditors and employees. Similarly, the Law Council noted that to the extent safe harbour is used to successfully implement informal restructuring plans, 'this generally serves the interest of creditors and employees as better outcomes will often be achieved through informal restructures than by use of formal processes which result in enterprise value loss and diminished returns to creditors.'[179] Other parties, including the ABA, ACF and the AICM, suggested that the interests of creditors should be at the forefront of the better outcome analysis. Some parties, such as KPMG, recommended an amendment to the wording of section 588GA(1)(a) to clarify it is a better outcome for both the company and its creditors.

In our view, the interests of creditors are already covered by the reference to 'company'. A director seeking to rely on the safe harbour provisions is doing so because the company is in financial distress and is seeking protection, ultimately, from the duty not to trade the company while it is insolvent. In those circumstances, the case law is clear: directors are under a duty to consider the interests of creditors (being an aspect of their general duty to act in the best interests of the company).[180] Accordingly, in determining whether something is a better outcome for the company, the directors must have regard to creditors.

We are also wary of any suggestion that the better outcome needs to be better for creditors *as a whole*. The reality of a company in financial distress, is that there are often creditors that are 'in the money' and those that are 'out of the money'. This was a point raised in King & Wood Mallesons' submission, which stated:

> *In this regard 'outcome for the company' should be viewed predominantly (but not exclusively) from the perspective of the stakeholders who are at marginal risk depending on the level of financial distress – if the financial distress has not reached the point of insolvency, that may be the shareholders; if it has reached the point of cash-flow insolvency, but not balance-sheet insolvency, that may be the unsecured creditors; if balance-sheet insolvency has been reached, it may be secured lenders and/or other priority creditors.*

For these reasons, the Panel considers it unnecessary for any amendment to be made to the wording of section 588GA(1)(a) to expressly recognise the interests of creditors in the better outcome

179 See also Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.8].

180 See *Termite Resources NL (in liq) v Meadows* (2019) 370 ALR 191 at [197]-[209], and the authorities cited therein.

analysis. We are comfortable that the provision, as currently drafted, requires consideration of the interests of key stakeholders, including creditors and employees.

Classes of creditors

Submissions were also received that suggested the better outcome should be compared against a better outcome for the company and 'all classes of creditors'. In other words, that directors be required to assess that each class of creditor is better off under the proposed course of action. This strikes the Panel as a dangerous concept, which would be not only unduly onerous on directors to determine but would create many of the same difficulties experienced in propounding schemes of arrangement. Classes can be nebulous and a requirement to ensure each class of creditor is better off will create complexity, cost and ultimately frustrate many turnaround plans.

That is not to say directors should ignore differences between creditors. The Explanatory Memorandum refers to 'new' creditors, when it observes that a director taking on new debt in connection with a course of action that the directors know will not see that creditor paid in full, would be 'ostensibly a breach of the general directors' duties as well as being dishonest'.[181]

This point is relevant where the director's 'course of action' is a better-planned insolvent solution (for example, a planned administration). Voluntary administrations are often the best way to re-set a failing company. To embrace the voluntary administration structure as another way of rescuing and supporting viable business for long-term success, is (in our view) important. That the safe harbour provisions give directors the ability to plan an administration in a way that maximises the company's ability to emerge from the administration as a going concern, is one of the safe harbour provisions' strengths.

However, where a planned administration is the proposed 'course of action', incurring debt in the meantime can appear blatantly unfair and wrong. For example, each of the following would appear (at least initially and without context) to be problematic:

- directors drawing down on bank facilities, knowing that the funds drawn cannot be repaid in full (and not disclosing that to the banks at the time), or
- directors ordering from a new third-party creditor (with whom they have not previously dealt) a large supply of new stock not paid for on delivery which the directors know will not be paid in full under their current preferred course of action.

However, some circumstances in which the directors find themselves will not be as stark. For example:

- a director's course of action is to pre-plan a DOCA with its key stakeholders and place the company into administration in 3 weeks' time
- that DOCA will see creditors compromised but still paid more than they would be in an immediate appointment, and
- it is important for the success of the DOCA, and for the better outcome analysis, that the company continues to trade as a going concern in the meantime.

Asking the directors in those circumstances to turn their minds to each individual creditor they deal with during the period they seek to rely on the safe harbour provisions (to work out whether each creditor is better off) could be a challenging task. The Panel is concerned that such a blanket proposition undermines the ability to use safe harbour provisions to effectively pre-plan a more efficient administration appointment. However, we recognise that the rights of creditors are also

181 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.39].

important, and that any re-allocation of that risk should only be considered in the context of a holistic review of insolvency laws. The Panel otherwise notes that there are some strategies directors in those circumstances may employ (for example, changing to 'cash on delivery', and/or ensuring a DOCA prioritises any debts incurred during the safe harbour period), which may assist directors in managing a pre-planned administration.

Desire for clarity and education

The Panel notes stakeholders' suggestions for further clarity regarding the meaning of a 'better outcome' in section 588GA(1)(a), such as additional guidance on the factors which must be taken into account when conducting the better outcome analysis, and when assessing the prescribed counterfactual in section 588GA(7).

There is a clear benefit in maintaining a flexible approach in the statutory provisions. An overly prescriptive approach risks failing to adequately strike the balance Parliament intended between 'the protection of creditors and encouraging honest, diligent and competent directors to innovate and take reasonable risks'.[182] Accordingly, the Panel does not recommend any legislative change. However, the Panel notes its recommendation in section 6.2 for further guidance and considers such guidance should include a non-exhaustive list of factors which may be taken into account when conducting the better outcome analysis.

8.4 Types of debts that can be incurred

Section 588GA(1)(b) provides that safe harbour provisions apply only to debts '*incurred … directly or indirectly in connection with any such course of action*'.

The main query raised in consultations was whether the terms 'directly or indirectly in connection with such course of action' extend to debts incurred in the ordinary course of business.

The Panel's view (which is consistent with feedback received through consultations) is that, in most circumstances, a course of action being pursued will involve the business continuing to operate as a going concern. In those circumstances, we consider it appropriate that debts incurred in the ordinary course of the company's business will be considered to be incurred in connection with the course(s) of action that see the company continue as a going concern. This is consistent with the Explanatory Memorandum which states that debts 'incurred directly or indirectly in connection with' a course of action would include 'ordinary trade debts incurred in the usual course of business'.[183]

However, King & Wood Mallesons noted in their submission that the different terminology used in the Insolvent Trading Moratorium (which referenced ordinary course of business debts) was language that, in their experience, directors better understood.[184] They commented that a reference to ordinary course of business debts 'had a marked effect on the comfort levels of directors'.

In the Panel's view, an amendment to section 588GA(1)(b) to specifically include debts incurred in the ordinary course of business (where the course of action involves the business continuing as a going concern) is beneficial. While we do not think it is strictly necessary, if it assists in facilitating directors' understanding of the provisions, we support that amendment.

182 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.12].

183 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.48].

184 King & Wood Mallesons submission, p 3.

9. Analysis of Section 588GA(2)

Section 588GA(2) – Working out whether a course of action is reasonably likely to lead to a better outcome

(2) For the purposes of (but without limiting) subsection (1), in working out whether a course of action is reasonably likely to lead to a better outcome for the company, regard may be had to whether the person:

(a) is properly informing himself or herself of the company's financial position; or

(b) is taking appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts; or

(c) is taking appropriate steps to ensure that the company is keeping appropriate financial records consistent with the size and nature of the company; or

(d) is obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; or

(e) is developing or implementing a plan for restructuring the company to improve its financial position.

We received a number of submissions on the operation of section 588GA(2). Stakeholders raised concerns about whether one or more of the factors set out in that subsection should be mandatory (in particular the appointment of an AQE), and also queried the meaning of the term 'an appropriately qualified entity'.

9.1 Should factors be prescriptive?

A number of submissions perceive the flexibility in the safe harbour provisions as a negative. They view it as creating uncertainty, which undermines their confidence that the provisions would protect the relevant director from a subsequent insolvent trading claim. Stakeholders suggested it would be helpful for a set of criteria to be developed that, if met, provided directors with reassurance that they have obtained safe harbour protection.

The Panel is of the view that 'safe harbour protection' is not something that can just be 'obtained' without also being constantly monitored. The Explanatory Memorandum makes it clear that while not all the factors need to apply, the flexibility of the legislation also means that even where all of the factors have been addressed, a court could still find that directors are not 'in' safe harbour.[185] Accordingly, even if the factors were mandatory and flexibility was removed, that wouldn't achieve a set-and-forget outcome because that is the antithesis of what the safe harbour provisions seek to achieve.

Other stakeholders argued that the flexibility of the provisions has encouraged exploration of whole-of-business strategies. They compare this to a tick-the-box or checklist approach that could

185 Per the Explanatory Memorandum, 'The factors in subsection 588GA(2) … provide only a guide as to the steps a director may consider or take depending on the circumstances, and also to the factors a Court may consider in any subsequent proceedings where the safe harbour is at issue': Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.65].

never accommodate the endless set of circumstances a particular company may be facing when they are in financial distress. It was put to the Panel that if safe harbour is to work as a restructuring and governance tool rather than as a compliance tool, users will have to accept some level of uncertainty and responsibility. The benefit of the flexibility of section 588GA(2), including the flexibility around the appointment of an AQE, was seen by them as outweighing any benefit in prescribing certain matters.

The Panel shares the concern that by making factors prescriptive, a tick-the-box approach to safe harbour would be encouraged which, in turn, heightens the risk of the directors obtaining bad advice.

The submissions were more specific regarding the appointment of an AQE. There were suggestions by Wexted, CA ANZ/CPA and AICM that the appointment of an AQE should be prescriptive or mandatory, rather than just a factor that directors should consider. Their reasons included that it is appropriate in the context of larger companies, and that knowing an experienced advisor would be involved would provide credit professionals with greater confidence in the safe harbour process generally.

The Panel agrees that the larger the company, the more likely it is that directors would see the appointment of an AQE as a necessity despite it not being prescribed. Consultations confirmed this is what is happening in practice. The Panel is not aware of any examples of a large company where its directors (wishing to avail themselves of safe harbour protection) have not appointed an AQE.

Some advisers point to the fact that, even though they are not prescriptive, it would be a brave director who did not review the factors listed in section 588GA(2) and make some effort to actively consider and apply them.

However, while there are many reasons safe harbour is not being utilised by smaller companies, the legislation, as enacted, is intended to be available to companies of all sizes and circumstances, and therefore needs to be flexible enough to apply in a variety of circumstances.

It is also important to consider the appointment of an AQE in the broader timeline applicable to companies in financial distress. There is often a short delay between the time directors become aware of underlying causes for concern, and an AQE being appointed. If an AQE is a mandatory factor for safe harbour to apply, then the directors may not be given enough lead time to ensure that they are appointing the right adviser. The Panel was informally provided with a couple of examples where an AQE was appointed in circumstances where, in that AQE's opinion, the directors were already actively engaging in safe harbour prior to the AQE's appointment.

For these reasons, we are of the view that the flexibility built into section 588GA(2) remains appropriate.

9.2 Role of advisers in the safe harbour: what is an 'appropriate qualified entity'?

One of the main points of contention about safe harbour provisions to emerge in the consultation process was the identity of an AQE.

Technically, section 588GA(2)(d) provides that one of the factors to be taken into account in working out whether a course of action will lead to a better outcome for the company, is whether the director *'is obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice*'.

In the Panel's experience (and this is supported by the Panel's consultation process) this is a hotly debated phrase in practice. It is divisive because it goes to the heart of who should support and advise companies through their financial distress, and what their role should be.

The divergence of opinion centres around whether there is just one AQE, whether there is a separate 'safe harbour master', whether the AQE needs to be a registered liquidator, and whether such an adviser needs to be regulated.

We think it helpful to analyse the role of the AQE first, as that then informs the identity of the AQE.

Role of AQE

The role of the AQE is to advise in connection with an assessment of whether a course of action is reasonably likely to lead to a better outcome for the company. What is involved in that assessment will differ from company to company and will depend on the course of action being pursued. For example, if the course of action is to raise capital in a listed entity, legal advice as to placement capacity or take-over provisions may be required, as well as advice from capital markets advisers as to the likelihood that such capital raising would be successful. If the course of action is to sell assets or property of the company, then advice from a valuer may be required. And, if the course of action is to increase capacity for a manufacturing plant, advice from an engineer or other expert in the field may be required. In many instances, each of these advisers may need to be supplemented by other turnaround specialists. Finally, a determination of the better outcome requirement also needs to be made. As noted above, the 'better outcome' is defined as an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, of the company.

There are some who suggest that there is a single AQE who takes the reigns of the safe harbour assessments, and either by itself, or with other qualified advisers and turnaround specialists, provides advice to the directors about the course of action and how reasonably likely it is to lead to a better outcome. Such a person is sometimes colloquially referred to as the 'safe harbour adviser' or 'safe harbour master'.

The concept of a single entity that then rallies other advisers as required, to provide safe harbour advice, appears to emerge from the use in the legislation of the singular '**an**' when referencing the appropriately qualified entity.

We are concerned that in creating a role of a 'safe harbour master' or a singular 'safe harbour adviser', there is a threat that the directors seek to delegate their responsibility to determine whether a course of action is reasonably likely to lead to a better outcome for the company. Ultimately, the directors need to make that commercial call. Those directors can take into account the advice of the informed and qualified adviser(s), but it needs to be the directors' decision to continue to pursue, or cease pursuing, the relevant course of action. To do otherwise appears to us to cede to an adviser the essence of the responsibilities and duties of the directors. It is also the director's responsibility to ensure that the cash flow forecasts and other financial information on which the advisers will base their 'better outcome' analysis, are reasonable.

It may be in practice that the distinction is unnecessary, and that the reality is that the 'safe harbour master' is a central adviser that acts as a project manager of the relevant advisers. However, while this role may be necessary in the application of the safe harbour provisions in large turnarounds, we do not think such a role is enshrined (or should be enshrined) in the legislation.

Rather, we view the reference to an 'appropriate qualified entity' to be one or more appropriately qualified advisers who provide the 'appropriate advice'. This is supported by the background provided in the Explanatory Memorandum.[186] We recommend that the reference to 'an appropriately

186 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.35].

qualified entity' be amended to 'one or more appropriately qualified advisers', to clarify that the necessary factor is the receipt of appropriate advice, not that it needs to come from, or through, one entity. We also discuss the implications of who retains an AQE below.

Who can be an AQE?

In recognising that the role of an AQE can be varied and needs to be flexible, it is self-evident that an AQE may be someone other than a registered liquidator. However, there is an important role for registered liquidators to play. The Panel recognises that in most circumstances, the experience of either a registered liquidator with turnaround experience or a turnaround specialist with deep insolvency knowledge will be required to analyse the 'better outcome'.

Certainly, in more complex or large safe harbour engagements, the Panel's experience (which is consistent with the feedback received) is that registered liquidators invariably are the advisers in respect of analysing the better outcome requirement. A better outcome assessment often requires experience as to the real cost of an administration and/or liquidation, applications of unfair preferences law, antecedent transactions, employee entitlements, security reviews, voting entitlements and priority waterfall entitlements. It will usually involve the preparation of a 'security statement' or 'security position'. A security statement or security position is a common industry tool which generally reflects a statement of the company's assets on a comparative basis between book values and the realisable values that may occur in a formal insolvency process. Estimates are also made of the likely quantum of liabilities of the company that may ultimately prove for payment in a formal appointment. These liabilities are considered in the context of the priorities under the payment waterfall contained in section 556 of the Act, and regard is also had to any costs of realisation and the external administrator's remuneration. Security statements or security positions, although they may not be termed that way, are commonly used by voluntary administrators to present the difference in returns to creditors under a DOCA versus liquidation scenario. It is in this context, comparing returns to creditors under the restructuring plan versus the formal insolvency counterfactual, that security statements or security positions would be used in a better outcome analysis.

ARITA's position is that only registered liquidators have the appropriate skillset to undertake such an analysis.[187] GSE Capital and KPMG support this position, but KPMG extends it to contemplate that it could be provided by an 'equivalently regulated person'.[188] Others who support the concept of the AQE being either a registered liquidator or regulated entity are ACF and AICM.[189]

While not requiring the entity performing the better outcome analysis to be a regulated entity, many submissions saw benefit in further clarification of what constitutes an AQE. CA ANZ/CPA's submission noted that in identifying the relevant qualifications an AQE may have, it is important to recognise 'that advice from several experts with differing skill sets may be required and will vary by the size of the company, the complexity of a corporate structure and the financial health of the business when safe harbour is entered'.[190]

We find the argument for flexibility compelling and are reluctant to endorse a view that requires a specific person to be appointed in all circumstances. As various submissions have noted,[191] the deliberate flexibility contained in section 588GA(2)(d) allows for a nuanced and adaptable application to companies of all shapes and sizes. A general theme running through this report is that SMEs' access of safe harbour is limited in practice, but absent any wholesale reform of insolvency laws that

187 ARITA submission, pp 24-26.
188 GSE Capital submission, p 7; KPMG submission, p 12.
189 ACF submission, p 2; AICM submission, p 5.
190 CA ANZ / CPA submission, p 4.
191 McGrathNicol submission, pt 6; Law Council submission, p 8; Vantage submission, p 40.

separately addresses SMEs, the provisions should still be capable of application to SME directors. Accordingly, the provisions need to be able to be enlivened by access to circumstance-appropriate advice in the SME market.

Other observations: factors to consider in appointing an AQE

We make 2 further observations on this point.

First, although we fall short of recommending that a registered liquidator be prescribed to provide the better outcome advice, we do wish to reiterate that in most circumstances a registered liquidator or someone with deep insolvency experience will be the appropriate adviser to provide the liquidation and voluntary administration analysis that informs and underpins the better outcome analysis. The unique position that the registered liquidator occupies is having the same lens (based on experience) that another liquidator will have when assessing the liquidation/ administration position in its better outcome analysis, and that a court may place greater weight on that.

However, a better outcome analysis also requires an analysis of the 'upside counterfactual'. No doubt, there are some registered liquidators with experience and skills to analyse financial models and forecasts, and to compare and evaluate the administration/liquidation analysis with the 'upside position', but not all have that experience. Further, in many (particularly complex) matters, industry-specific experts will be required to attest to models and forecasts. In addition, ARITA's survey suggests that there are registered liquidators who have not provided safe harbour advice to date and some, for various reasons, who are not likely to engage in performing safe harbour advisory work.

Second, that anyone providing the AQE advice should be insured to do so. The Explanatory Memorandum refers to accountants being possible AQEs.[192] It may be that particular advice can be appropriately provided by, for example, the SME's local accountant. However, our consultation process revealed that it was clear that many accountants are simply not insured to provide insolvency or turnaround advice, and to the extent that was what they were being briefed to provide, they may not be 'appropriately qualified' to do so. In those instances, directors think they are receiving 'appropriate advice' but do not understand how to evaluate the appropriateness of it.

Each of these observations highlight, once more, the gap in awareness of what directors should be looking for in seeking to engage an AQE.

Regulation

A number of submissions suggested that AQEs should be separately regulated. Given the Panel's view that AQEs are not limited to registered liquidators, the Panel has considered that suggestion in the context of who performs the better outcome analysis. We have already noted that in most circumstances that will be a registered liquidator or someone with deep insolvency experience.

We see no immediate need for this to occur as a separate category of regulation. Such regulation would undoubtedly come at increased cost. Further, many advisers are already subject to regulation in their relevant industry (for example, registered liquidators). While we received some feedback relating to 'dodgy advisers', such references were anecdotal and we have not received evidence or examples of specific instances where shonky advisers have corrupted or otherwise tainted the application of the safe harbour provisions. For the moment, there are insufficient reports of misuse to justify such additional bureaucracy. This may be an area government needs to monitor, as if the

192 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.35].

instances of dishonest or negligent advisers becomes more prevalent, specific regulation may be needed.

Conflicts

Finally, some stakeholders raised concerns about conflicts in the context of AQE appointments. These arose in 2 contexts.

- First, should any existing relationships between a proposed AQE and a company preclude an AQE appointment? We are of the view that there are some roles where conflicts will be difficult to overcome (for example, the proposed AQE is also the auditor of the company). We fall shy of recommending an AQE be independent and free of conflict as we think that is too prescriptive and limiting and difficult to regulate, particularly in longer-term safe harbour appointments. However, we are of the view that it is a factor directors should consider when appointing an AQE. In some circumstances the 'appropriate' requirement will also mean they should be independent.
- The second context is when an AQE later seeks a role in a formal restructuring (either as an administrator or liquidator). Several stakeholders (including Deloitte, Wexted and ARITA) were clear in their submissions that if a registered liquidator took on a role as an advisor in safe harbour, then he or she should not later act as either voluntary administrator or as liquidator of the company. This is to avoid registered liquidators being placed in positions of actual conflicts, as well as perceived conflicts.

Others, such as the Law Council and McGrathNichol, thought the position uncertain as to whether a registered liquidator who provided safe harbour advice is capable under the law of accepting a formal appointment. The Law Council noted that there may be some merit in not excluding such parties outright. There are obvious efficiencies and synergies in a company (and, in a derivative sense, its creditors) not duplicating the costs of an AQE and the costs of an administrator/liquidator. Of course, 'efficiencies' is a vexed question, because there are also problems associated with an administrator or liquidator of a company being asked to opine on whether solvency advice they previously provided or their better outcome analysis was right. However, there is precedent for certain conflicts or perceived conflicts being managed by the appointment of an independent third party.[193] Ultimately it is a question of fact that has regard to the work undertaken, remuneration received and the bespoke situation of the company.

The concern, from the perspective of the safe harbour provisions, is that advisers often hold back from engaging with a company, or do not want to provide safe harbour advice, for fear of losing a potential formal appointment role. This is a common theme that emerged from consultations. It also has implications for the impartiality of the advice a company receives: if an adviser has a vested interest in a particular course of action, there is a greater risk the adviser's personal preferred course of action is the one that is recommended. This will not be the case for all advisers, or all companies. The Panel recognises that there are conflicts (and perceived conflicts) on both sides of this debate.

When an AQE assists with pre-planning administration advice, the Panel can envisage occasions where their involvement should not automatically conflict with them acting in a formal capacity in any later appointment,[194] and we caution against any amendments to the safe harbour provisions which would seek to exclude absolutely any AQE from a later formal role. We also note that the safe harbour provisions are not the right place to address any such concerns, and that matters of independence for the appointment of administrators and liquidators are best dealt with by Courts (in considering the independence of such registered liquidator by reference to the independence

193 Korda, in the matter of Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed) [2017] FCA 914.

194 Korda, in the matter of Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed) [2017] FCA 914.

requirements set out in section 532(2) the Act), as well as by the relevant professional bodies who oversee the codes of conduct governing such registered liquidator. It is outside the ambit of our Review to consider the appropriateness of those sections or standards.

Summary

The Panel endorses the suggestion of the Law Council that AQE eligibility criteria be produced. The Panel's view is that such criteria should be general in nature, and could draw on the criteria referred to in the Explanatory Memorandum,[195] and otherwise include:

- a statement that the appropriate qualifications of the adviser will depend on the nature of the advice being sought
- where applicable, a person's membership of relevant industry bodies will be a relevant indicator of qualification (for example, whether they are a registered liquidator, lawyer, financial adviser or accountant), and
- that the adviser holds professional indemnity insurance for the type of advice being sought.

It would be helpful if the criteria or guide gave examples, but the Panel cautions against it being too prescriptive.

The Panel is of the view that a combination of the following 2 points will provide clarity and flexibility to directors, advisers and industry participants:

- legislative clarification that an AQE can be 'one or more appropriately qualified advisers', and
- a publicly available, easily sourced (high level) guide as to how the 'appropriateness' of an AQE is to be assessed.[196]

9.3 Section 588GA(2): Other factors

Two other questions emerged from the Panel's consultation process on section 588GA(2).

a) Financial Position

The first related to whether 'in properly informing himself or herself of the company's financial position' a director needed to have regard to only the current financial position of the company, or also to forecasts and cashflow.

In the Panel's view, the assessment of solvency (as summarised in section 5.1 of this Report) includes an element of forward-looking analysis which requires directors to also be considering the company's future debts. Many of the industry participants with whom we spoke emphasised that one of the first tasks they undertake following any safe harbour appointment (or indeed, any turnaround or restructure appointment), is a 13-week cash flow forecast and 3-way financial model. The Panel views such an approach as sensible and appropriate. It is not clear to us how a reliable assessment of whether a course of action is reasonably likely to lead to a better outcome for the company can be made where the company's forecasts and cashflows are not tested and considered. The Panel considers that no change is required to the current drafting of the provision.

195 See [1.69] and [1.74] of the Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth).

196 See section 6.2 of this Report in respect of how guides may be produced.

b) Misconduct

The second question related to what is meant by a director 'taking appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts'. In particular, what is meant by 'misconduct' and whether:

- it is limited to only misconduct that could adversely affect the company's ability to pay all its debts (that is, that there needs to be a causation element), or
- a failure of the restructuring plan such that a company cannot ultimately pay all its debts constitutes misconduct.

The question of misconduct only arose in a small number of written submissions and round-table discussions. Most stakeholders indicated that it is not a regularly engaged factor (that is, there are few examples of safe harbour in practice where misconduct needs to be assessed in any particular detail).

The factors set out in section 588GA(2) are illustrative only, and are not an exhaustive list of factors that a Court would consider. Nonetheless, we are of the view that:

- where misconduct of officers or employees has no effect on the company's ability to pay all its debts, it is unlikely to be a relevant factor in the availability of the safe harbour protections (although it may be relevant to other director duties), and
- a failure of the restructuring plan and the ultimate inability of the company to repay its debts should not, of itself, constitute misconduct (as that would substantially undermine the utility of the safe harbour provisions). Of course, if the restructuring plan itself didn't meet the legislative requirements for being 'reasonably likely to lead to a better outcome', then that will be the relevant analysis. This is also consistent with the explanation given in the Explanatory Memorandum,[197] which noted 'there are many variables that could impact on a company's rehabilitation, some of which may not be possible to predict.'

Whether the misconduct factor is relevant will depend on the bespoke circumstances of each safe harbour analysis. However, we are of the view that it has more obvious application in instances of fraud or bribery and other asset-diminishing activities, rather than taking steps to ensure full compliance with all of the company's codes of conduct. The Panel is of the view that the current drafting is appropriate.

c) Restructuring

Section 588GA(2)(e) uses the term 'restructuring' which is now a defined term in section 9 of the Act and is defined inappropriately (for the purposes of section 588GA(2)(e)) by reference to restructuring under the SBR regime.

The Panel recommends that either the reference to the term 'restructuring' in section 588GA(2) be replaced, or the definition of restructuring in section 9 be updated to include a definition for the purposes of section 588GA(2)(e).

197 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.50].

10. Analysis of Section 588GA(3)

10.1 Evidential Burden

Section 588GA(3) states that any person who wishes to rely on section 588GA(1) in a proceeding bears the evidential burden to prove the elements set out in that section. That means the director must adduce or point to evidence that suggests a reasonable possibility that the matter did or did not exist (that is, whether or not the director is entitled to the safe harbour protection in section 588GA(1)).

A related provision is section 588GB, which is titled '*when books or information not admissible for the safe harbour*'. It requires directors to hand over the books of the company to an administrator or liquidator (as relevant), or else be barred from seeking to have them admitted as evidence in a relevant proceeding (which includes a proceeding alleging a breach of insolvent trading laws). The intention behind section 588GB is to require that administrators and liquidators are provided with the materials evidencing safe harbour at the start of their appointment.[198]

10.2 Analysis

Most stakeholders were comfortable with directors bearing that evidential burden. However, some identified confusion about who appoints the AQE and questioned to whom the AQE's 'work product' belongs. In particular, this was raised in the context of legal advice obtained by the directors, which (absent sections 588GA(3) and 588GB) may have been subject to legal privilege.

Safe harbour blurs the lines between advice provided to directors (given the prohibition on insolvent trading is primarily a director matter), and advice provided to the company (given that a 'course of action' is usually one to be taken by the company at the behest of the directors and therefore is something in which the company is intimately involved).

In the Panel's view, it is the directors' duty to avoid insolvent trading, and it is the directors who need to avail themselves of the legislative carve-out to defend an insolvent trading claim. As currently constructed, it is the fact that the director is obtaining advice from an AQE which is an express relevant factor under 588GA(2)(d). Therefore, in most circumstances, the retainer for any AQE is likely to be with the directors, although we are aware of some circumstances involving a joint retainer for the directors and the company if the AQE is providing advice generally in respect of restructuring options. There are also circumstances where the retained lawyer engages the other advisers pursuant to the legal retainer, including in respect of obtaining a better outcome analysis.

The concern raised relating to work papers or product is whether they are the property of the directors or whether they belong to the company. The answer is fact dependent. The terms of the AQE's retainer and how the work product has been produced will be relevant factors. There may be circumstances in which this work product would (unless relied on) be material over which a director may also make a claim of legal privilege. In larger companies there is often an army of advisers (including, for example, separate counsel for non-executive directors) which may make the boundaries between work product produced for the company and the directors easier to define, but this is a luxury many smaller companies cannot afford.

The prospect that materials evidencing safe harbour may not fall under the 'books and records of the company' does not appear to have been contemplated in the drafting of section 588GB and undermines the legislative intent behind that section. We note that sections 438B and 530A, which

198 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.20], [1.21] and [1.23]-[1.24].

would otherwise require a director to deliver all books in the director's possession that relate to the company, may not apply to material over which a director asserts privilege.

A legislative change to section 588GB to extend it to books and records (in the directors' possession or control) that constitute materials evidencing safe harbour (even when they do not form part of the books and records of the company) should be considered.[199] The effect of that amendment would be, unless the director handed over such material at the time of appointment, the director would be barred from producing those books and records to establish safe harbour in any relevant proceeding.[200] This amendment is not meant to extend to a requirement that the director be compelled to provide such materials (which may raise concerns regarding maintenance of privilege), but only that they not be permitted to produce that evidence at a later date to satisfy the evidentiary burden.

Some stakeholders separately raised the concern that handing over work product (to satisfy the evidential burden) may negate certain Directors & Officers' Liability (**D&O**) insurance policies. The Panel has not received evidence of circumstances where this has occurred, or has been alleged, but notes it is likely that such evidence would only emerge if an insolvent trading claim against a director is progressed, and there have been few instances of this since the safe harbour provisions came into effect.

The confusion over ownership of the safe harbour work product is amplified in a company group scenario. Pursuant to section 588V of the Act, the holding company of the insolvent (or about to become insolvent) subsidiary becomes liable for the debts incurred by that subsidiary while insolvent.

Section 588V provides that a holding company contravenes the section if at the time the subsidiary incurs a debt:

- the subsidiary is insolvent or becomes insolvent by incurring that debt
- there are reasonable grounds for suspecting the subsidiary is insolvent, or would become insolvent, and
- either or both of the following apply:
  - the holding company or one or more of its directors is aware there are grounds for so suspecting, or
  - having regard to the nature and extent of the holding company's control over the subsidiary's affairs, it is reasonable to expect that the holding company would be so aware (or that any of its directors would be so aware)

Section 588WA of the Act provides safe harbour protection for the holding company, if:

- the holding company takes reasonable steps to ensure that the safe harbour protections apply to the directors of the subsidiary and the relevant debt; and
- the safe harbour provisions do so apply.

On that basis, the holding company would need to see evidence of compliance with the safe harbour provisions by the directors of the subsidiary, which may mean that the directors are required to provide copies of work product produced for them (some of which may potentially be privileged) to the holding company. That would then become part of that holding company's books and records, further blurring the line between the books and records of the company, and those of the directors.

199 This would also be consistent with the director's obligations under, for example, sections 438B and 530A.

200 Matters of privilege may also need to be addressed (particularly so that privilege is not waived in respect of third parties such as shareholders or other creditors).

The Panel considers it appropriate that section 588GA(3) remains as drafted, and that directors continue to be obliged to bear the (relatively low) evidential burden to enliven the safe harbour protection. However, given the potential implications this issue has for disputes concerning legal privilege, and D&O insurance coverage, consideration should be given to whether section 588GA(2)(d) should be amended to include (in addition to the current drafting) circumstances where the *company* obtains advice from an AQE.

11. Analysis of Section 588GA(4)

Section 588GA(4) – Matters that must be being done or be done

Matters that must be being done or be done

(4) Subsection (1) does not apply in relation to a person and either a debt or disposition if:

(a) when the debt is incurred, or the disposition is made, the company is failing to do one or more of the following matters:

(i) pay the entitlements of its employees by the time they fall due;

(ii) give returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the Income Tax Assessment Act 1997); and

(b) that failure:

(i) amounts to less than substantial compliance with the matter concerned; or

(ii) is one of 2 or more failures by the company to do any or all of those matters during the 12 month period ending when the debt is incurred;

unless an order applying to the person and that failure is in force under subsection (6).

Note: Employee *entitlements* are defined in subsection 596AA(2) and include superannuation contributions payable by the company.

(5) Subsection (1) is taken never to have applied in relation to a person and either a debt or a disposition if:

(a) after the debt is incurred, or the disposition is made, the person fails to comply with paragraph 429(2)(b), or subsection 438B(2), 475(1), 497(4) or 530A(1), in relation to the company; and

(b) that failure amounts to less than substantial compliance with the provision concerned;

unless an order applying to the person and that failure is in force under subsection (6).

(6) The Court may order that subsection (4) or (5) does not apply to a person and one or more failures if:

(a) the Court is satisfied that the failures were due to exceptional circumstances or that it is otherwise in the interests of justice to make the order; and

(b) an application for the order is made by the person.

As noted previously in this Report, there are preconditions (sometimes referred to as safeguards) that need to be satisfied for a director to be able to rely on the safe harbour provisions. A director may not avail themselves of the protections in section 588GA(1) if the company is failing to pay the entitlements of its employees by the time they fall due, or is failing to lodge all tax lodgements as required under taxation laws, and such failure either amounts to less than substantial compliance or is one of 2 or more failures in the last 12 months.

Three concerns have been raised about this provision. First, in a general sense, whether the preconditions are appropriate, or whether they should be removed entirely. Second, whether the drafting of the section is appropriate, considering other sections of the Act and *Corporations Regulations 2001* (Cth) (**Corporations Regulations**) which deal with similar subject matter. Third, what is meant by 'substantial compliance' and the technical failures described in subsection (4)(b)(ii).

11.1 Appropriateness of pre-conditions

Some stakeholders say the preconditions are too onerous and should be removed, and others suggest the provisions would be improved by the introduction of 'cure periods.'[201] The majority of submissions consider the pre-conditions to be appropriate, noting that they:

- are necessary in understanding the true current financial position of a business
- reflect the minimum standard for good governance and managerial diligence that should be afforded to a director seeking safe harbour protection
- are not overly burdensome, unduly onerous, or unreasonable, and
- are seen as important safeguards to prevent misuse.[202]

Vantage makes the observation that the mandatory preconditions assist in 'identifying those companies that might be said to be poorly run, inadequately resourced and lacking in appropriate controls – in turn, picking up companies that are not viable.'[203]

The Panel considers the emphasis on viability key. Safe harbour is not a mechanism to save every business and it is important to distinguish between businesses that have a reasonable prospect of long-term viability (not withstanding short-term challenges) and those that are not viable. Businesses that are not viable should be wound up early, and the pre-conditions to safe harbour are intended to assist in that differentiation.

In relation to SMEs in particular, a number of submissions raise the issue of the pre-conditions being a reason why SME directors are unable to avail themselves of safe harbour protection. For example, the majority of respondents to a specific question on this issue in ARITA's survey of its professional members, suggested that fewer than 10% of SMEs would qualify due to these requirements.[204]

In the Panel's view, based on the policy intent behind the safeguards, it is not appropriate to remove or relax the pre-conditions for all companies to make safe harbour more accessible for SME directors. Amendments to the existing legislation to relax the pre-conditions are unlikely to fix accessibility concerns for SME directors in any event.[205] Rather, we would prefer that accessibility issues are addressed by some of the amendments considered below in relation to clarifying that technical or trivial non-compliance should not exclude a director from the safe harbour protections.

The ambit of section 588GA(4(a)(ii) was also queried by several stakeholders. Their issue relates to the expansive definition of taxation reporting obligations in section 588GA(4)(a)(ii), which refers to the ITAA. Stakeholders noted that such a far-reaching definition makes it very difficult for directors to be comfortable that they have complied with the pre-condition. Most directors are aware of their major reporting obligations being BAS lodgements for pay as you go (**PAYG**) and goods and services tax (**GST**), FBT returns, Income Tax returns, Single Touch Payroll reporting and super guarantee charge (**SGC**) statements. It was submitted to the Panel that having a defined list of reporting obligations (similar to that in section 588FGA), rather than a generic reference to the entire ITAA, will create more certainty for directors.

It was also put to us that having a defined list of reporting obligations would assist in removing unnecessary time and cost involved in determining whether a company had substantially complied.

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201 See submissions by the Law Council, ABA, IPA and ASBFEO.
202 See submissions by CA ANZ / CPA, ARITA, Wellard, Wexted, ACF, Vantage, Deloitte, TMA,McGrath Nicol, AICM, KPMG, AICD.
203 Vantage submission, p 18.
204 ARITA submission, Appendix A, p 29.
205 See sections 6.1 and 7.1(b) of this Report for further explanation on the safe harbour accessibility concerns for SME directors.

For directors, there should be as little uncertainty as possible about whether the pre-conditions have been met, and legislative clarification on what directors must achieve in order to be able to access the safe harbour provisions is important. Consultations have shown significant support for prescribing the list of tax lodgement obligations under section 588GA(4)(a)(ii) that must be complied with, and the Panel supports this suggestion.

11.2 Inconsistent provisions

ARITA's submission raises the issue of inconsistency in the eligibility requirements between the safe harbour provisions in section 588GA(4), the obligations in regulation 5.3B.24 for a company undergoing a SBR under Part 5.3.B of the Act and the obligation under section 500AA(1)(g) for a company to be eligible to undergo a simplified liquidation process.[206]

Regulation 5.3B.24

This regulation is satisfied in relation to a company under restructuring if:

(a) the company has:
  (i) paid the entitlements of its employees that are payable
  (ii) given returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the Income Tax Assessment Act 1997); or

(b) the company is substantially complying with the matter concerned.

Section 500AA(1)(g) states: the company has given returns, notices, statements, applications or other documents as required by taxation laws (*within the meaning of the Income Tax Assessment Act 1997)*.

There are 3 alternative expressions dealing with the same matters in the Act. We agree with ARITA's submission that this creates inconsistency and a lack of coherence and consistency in implementing the underlying policy issues.[207]

Section 588GA(4)(a) refers to the payment of employee entitlements 'by the time they fall due', whereas the wording of Regulation 5.3B.24 refers to the payment of employee entitlements 'that are payable'. Consultations have shown a preference for the wording in Regulation 5.3B.24.

Section 588GA(4)(b) refers to 'less than substantial compliance' and 'is one of 2 or more failures by the company to do any of all of those matters during the 12-month period ending when the debt is incurred'. Regulation 5.3B.24 refers to the company 'substantially complying with the matter concerned' only and section 500AA(1)(g) does not mention substantial compliance at all, although we understand a 'substantial compliance' amendment to section 500AA(1)(g) is currently before the Senate.

There does not appear to us an obvious policy reason why the 3 references should not be consistent. The Panel considers (subject to the qualification in respect of what is required under taxation laws) that the wording contained in Regulation 5.3B.24 is more user-friendly and should be preferred.

206 ARITA submission, pp 20-21.
207 ARITA submission, p 20.

11.3 Substantial compliance – Section 588GA(4)(b)

A number of submissions raised concerns over technical or trivial non-compliance that may be caught by the wording of section 588GA(4)(b) and more generally what 'substantial compliance' means.

There appears to be particular confusion over the reference to the failure being 'one of 2 or more failures by the company to do any or all of those matters during the 12-month period ending when the debt is incurred'. Stakeholders advised the Panel that considerable effort and cost is being expended in trying to determine if companies are technically complying with this provision, when the policy intent was focused on serious or serial failings.[208]

The Panel's consultation process has revealed support for an amendment to section 588GA(4)(b) which removes 588GA(4)(b)(ii), leaving the 'substantial compliance' safeguard. This is consistent with the drafting of Regulation 5.3B.24.

In our view, simplifying the wording of the legislation would make it easier and less costly for directors to determine if they are complying with the pre-conditions. Directors' focus should be on the better outcome analysis rather than detailed analysis of technical compliance with the pre-conditions.

Separately, some stakeholders noted that the safe harbour provisions would be enhanced by a definition of substantial compliance.

As it is currently framed, there is an argument that 'substantial compliance with the matter concerned' would require substantial compliance with each return or type of notice that is required by taxation laws (under section 588GA(4)(a)(ii)). The Panel's view is that substantial compliance should be assessed broadly with regard to all employee entitlements or tax lodgements (as relevant), and not pick up technical, trivial or minor matters. The Panel is supportive of a definition of substantial compliance being included in section 588GA(4) to provide greater certainty to directors about the necessary thresholds that must be met before safe harbour protection is engaged.

A matter that has occurred to the Panel and been raised as part of the consultation process, is the prevalence of wage underpayment issues which have arisen since the safe harbour legislation was introduced. The Panel considers there may be a gap where honest, competent directors who would otherwise believe they had substantially complied with the pre-conditions during a safe harbour, discover an employee wage underpayment issue that they were not previously aware of. In such circumstances there may be good policy reasons to allow the directors to still avail themselves of safe harbour protection.

The Panel does not have any specific recommendations in response to this concern, other than to note that it may be a situation that can be addressed by section 588GA(6). Pursuant to that provision, the Court has power to make orders that section 588GA(4) does not apply where the relevant failures were due to exceptional circumstances or where it is otherwise in the interests of justice to make such an order. Whether such circumstances would enliven the Court's discretion would turn on the facts of each case.

208 Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No 2) Bill 2017 (Cth), [1.79].

12. Analysis of Section 588GA(5)

Section 588GA(5)

(5) Subsection (1) is taken never to have applied in relation to a person and either a debt or a disposition if:
  (a) after the debt is incurred, or after the disposition is made, the person fails to comply with paragraph 429(2)(b), or subsection 438B(2), 475(1), 497(4) or 530A(1), in relation to the company; and
  (b) that failure amounts to less than substantial compliance with the provision concerned;

unless an order applying to the person and that failure is in force under subsection (6).

Relatively few submissions referenced this subsection and those that did, did not query its application in relation to the books and records of the company.

ARITA's submission refers to the law incentivising 'the provision of comprehensive, complete and accurate books and records…This means that liquidators are more likely to receive books and records where directors seek to rely on safe harbour – resolving a common issue in SME liquidations of books and records not being provided.'[209] The submission also suggests that the safeguard assists in preventing general misuse of the safe harbour provisions.[210]

The Panel refers to the discussion of the evidentiary burden in section 10 of this Report, which also addresses section 588GA(5). Subject to the views expressed in that section, the Panel is of the view that the safeguard in section 588GA(5) (and by extension section 588GB) to require a person to assist an external administrator in a subsequent formal insolvency by providing them with information about the company's affairs and providing the company's books and records to an administrator or liquidator remains appropriate.

209 ARITA submission, p 16.
210 ARITA submission, p 19.

13. Analysis of Section 588GA(6)

Section 588GA(6)

(6) The Court may order that subsection (4) or (5) does not apply to a person and one or more failures if:
  (a) the Court is satisfied that the failures were due to exceptional circumstances or that it is otherwise in the interests of justice to make the order; and
  (b) an application for the order is made by the person.

While some submissions suggested clarity around terminology to reduce a director's potential need to rely on the discretionary relief in subsection (6), no submissions queried its general application.

We are of the view that it remains appropriate for discretionary relief to be available to directors.

PART IV
OTHER CONSIDERATIONS

14. Other considerations

14.1 Reporting

Several submissions raise the point that, due to the confidential nature of safe harbour, there is a lack of data available to determine if directors are relying on the safe harbour provisions. There are suggestions that this data be captured through the following mechanisms:

- to determine directly from directors if they have been relying on the safe harbour provisions, provide an ability to capture use in the company annual statement issued by ASIC each year
- where a director seeks to rely on safe harbour protection in a subsequent administration or liquidation, capture that through the Form 507 (Report on Company Activities and Property) which directors must complete
- to determine use identified by registered liquidators, capture that through the Form 908 Annual liquidator return or Initial Statutory Reports (**ISR**) prepared by liquidators.

Even those submissions that suggested capturing this data acknowledged that confidentiality must be maintained, particularly where they are suggesting directors provide acknowledgement of their use of the provisions in company annual statements. The AICD/BCA submission acknowledges that lack of visibility on the use of safe harbour is a by-product of the confidential nature of the regime and that a requirement to report, even if it is confidential, may provide a disincentive for directors to use the provisions. The Panel cautions against any reporting regime that requires directors to contemporaneously acknowledge reliance on the safe harbour provisions. We are of the view that it will act as a disincentive to directors utilising the safe harbour provisions, for fear of such acknowledgment becoming public.

Collection of data from registered liquidators in their Form 908 Annual liquidator return will only capture information where they have been appointed either as a safe harbour adviser or as a subsequent administrator or liquidator. Although this will not capture all AQEs, the Panel is of the view that (provided the cost of collecting data is not too high), there is utility in using existing forms to garner information from at least one key industry participant.

In respect of ISRs by liquidators (under section 533 of the Act), these are only required if there is misconduct, or a liquidator expects to pay a dividend of less than 50c in the dollar. So, by definition, while most liquidations end up having an ISR prepared and lodged with ASIC, not every liquidation will. ISRs do capture misconduct which may include insolvent trading, however, the Panel is advised it is only supplementary reports to ASIC that may include information about section 588GA reliance.[211]

211 ASIC undertook a preliminary review of supplementary reports lodged under section 533(2) of the Act for the Panel. Between 29 March 2020 and 29 October 2021 there were 659 reports lodged under section 533(2) of the Act, of which 576 (87.4%) alleged that the director traded while insolvent. Of those 576 reports, 81(14 per cent) indicated the liquidator was aware the director may have a defence. ASIC also reviewed the free text descriptions of the potential defence and identified 4 that specifically referred to safe harbour under section 588GA. However, none of those referred to the steps taken to seek the protection of safe harbour. Seven reports referred to the section 588GAAA temporary safe harbour. ASIC has advised that, on further review, the preliminary analysis may be subject to change before it is published by ASIC.

The Panel sees utility in a data collection point being included in reports provided by voluntary administrators and liquidators. While this would relate only to safe harbours that have ended in formal appointments, it would allow for further quantitative analysis on the use of safe harbour in such circumstances, and its success in preventing a worse outcome for the company. Such reports would also assist in assessing any difficulties for registered liquidators in pursuing insolvent trading actions.

14.2 Transparency and engagement

Most stakeholders, when considering issues of transparency, were adamant that confidentiality of a director relying on safe harbour should be maintained, other than where the company chooses to engage with a third party in connection with implementing its course of action. Stakeholders observed that such engagement is quite common with financiers and, more variably, other key creditors, because without the support of those key creditors it is unlikely a plan can be successfully implemented.

ARITA's submission noted that, generally speaking, without creditor engagement and support, creditors would need to be paid in the ordinary course of business during a restructure, otherwise the company runs the risk of recovery actions including winding up applications being taken.

Credit agencies, however, are concerned about a lack of engagement. AICM, in particular, noted increased disengagement by directors during the period the Insolvent Trading Moratorium was in force and are concerned this practice will continue under the guise of safe harbour.[212] They see early engagement as the most effective way for all stakeholders to achieve a better outcome and note that credit professionals will look to support viable businesses.[213] From a director's perspective, raising safe harbour with creditors runs the risk of those creditors being alarmed enough to curtail future supply, which may be enough to put an end to any restructuring plan.

The issue of transparency for creditors is complex. The more a creditor knows, the more they could be exposed to unfair preference recovery action in a subsequent liquidation. The credit agencies again submit that it is unfair for directors to be protected by the safe harbour provisions, when creditors are not protected from being penalised for supporting a debtor through a turnaround plan that fails. Some submissions asserted that creditors should be excused from unfair preference claims for payments made while a director was relying on the safe harbour provisions.

We have some sympathy for this position, but the issue of preferences is also complex, as the original policy intent behind them was to ensure that the assets of an insolvent company are distributed equally among creditors and that no one creditor (particularly those with more knowledge or power than others) receives preferential treatment. We discuss this further in section 15.2.

14.3 Listed companies

One submission commented that safe harbour protections should not be available for public company directors.[214] The Panel disagrees and thinks the availability of safe harbour protections for all directors is not only appropriate but an important part of the turnaround armoury for the directors of listed companies that find themselves in financial distress.

212 AICM submission, p 3.
213 AICM submission, p 4.
214 GSE Capital submission, p 7.

14.4 Time limits

The Panel received some submissions about imposing formal time limits on the duration of the safe harbour protections.[215] We are concerned that an arbitrary time limit will constrain the way in which the safe harbour protections can apply, particularly in complex scenarios (when a process is included to seek Court approval to have time limits extended). Any such extension request would come with increased costs and is also likely to be public.

Subsections 588GA(1)(b)(i) and (ii) already specify that safe harbour protections cease on the earlier of: the person failing to take such course of action within a reasonable time and when the person ceases to take any such course of action. A 'reasonable time' will differ depending on the complexities involved and the actions required. We are of the view that this flexibility is important given the myriad different scenarios to which the safe harbour protections are applicable. This, coupled with the requirement under subsection 588GA(1)(b)(iii) that the safe harbour protections cease if the plan ceases to be reasonably likely to lead to a better outcome for the company (which requires the directors to monitor progress and evaluate the likelihood), offer sufficient protection from a stagnating safe harbour. Accordingly, we are of the view that the existing language is appropriate, and that formal time limits are not required to prevent potential abuses.

14.5 Creditor defeating dispositions

The Commonwealth's legislation targeting illegal phoenix activity came into effect in 2020.[216] The new law makes safe harbour available to officers and other persons as a defence against an alleged contravention of the creditor-defeating disposition prohibitions. In effect, a creditor-defeating disposition is not voidable (nor subject to court orders under section 588F of the Act) if the disposition was made in connection with a course of action that satisfies the safe harbour provisions.

The Panel notes that the illegal phoenixing provisions were enacted too recently to ascertain their interaction with safe harbour. The Panel did not receive any submissions that considered the application of safe harbour vis-à-vis the recently enacted illegal phoenixing provisions.

The safe harbour carve-out as it applies to the illegal phoenixing provisions should be recognised as a tool that promotes good governance; one that can only be utilised by honest, diligent directors acting in the best interests of the company.

14.6 Section 596AC

In 2019, by virtue of the introduction of sections 596AB (dealing with criminal offences) and 596AC (dealing within civil contraventions) into the Act,[217] the Commonwealth introduced general obligations (including on directors and officers of a company) to preserve employee entitlements. It provides that an officer of the company contravenes section 596AC(3) where the person causes the company to enter into a relevant agreement or transaction where they know (or a reasonable person in their position would know) that the relevant agreement or the transaction is likely to either avoid or prevent the recovery of the entitlements of employees of the company, or significantly reduce the amount of the entitlements of employees of the company that can be recovered. Under section 596AB(1C), it is an offence if the contravention by the officer is reckless as to whether the relevant agreement or the transaction is likely to either avoid or prevent the recovery of the entitlements of

215 GSE Capital submission, p 7; KPMG submission, p 14.

216 *Treasury Laws Amendment (Combatting Illegal Phoenixing) Act 2020* (Cth).

217 *Corporations Amendment (Strengthening Protections for Employee Entitlements) Act 2019* (Cth), effective 6 April 2019.

employees of the company, or significantly reduce the amount of the entitlements of employees of the company that can be recovered.

An extract of the relevant sections is included as Annexure E.

At the time directors are seeking to rely on the safe harbour provisions while pursuing a course of action that will lead to a better outcome for the company, sections 596AB and 596AC appear to require that a separate analysis be undertaken to determine whether any agreement or transaction entered into during that period (or at any other time) has the effect of significantly reducing the amount of any entitlements to employees of the company that can be recovered.

Wellard gives the hypothetical example of a restructuring plan that involves the sale and transfer of a business from a company in the twilight zone of insolvency, to a purchaser.[218] The terms of the sale do not see all liabilities transferred (including, for example, some employees). This is not an uncommon feature in an informal restructuring plan: that a 'stub company' remains post a sale, with assets and/or liabilities that are not to be transferred, which will then be wound up through a process.

Under the safe harbour provisions, the restructuring plan would need to satisfy the better outcome requirements. However, in some circumstances, it may be that while a restructuring plan satisfies the requirement that it be better for the company *as a whole* (and even creditors *as a whole*), it may not be better for employees as a whole (or may not be better for a sub-set of employees). The introduction of sections 596AB and 596AC require directors to have particular regard to the difference in position of employees under any plan, and, if there is a difference, then the relevant transactions will need to be entirely effectuated through a formal insolvency process rather than informally.

As the Wellard submission points out, there are conflicting signals sent to directors via the introduction of these new provisions.[219] Wellard highlights that in the Explanatory Memorandum to the Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018 (Cth), the following explanation was provided as a reason for excluding DOCAs from the ambit of the new provisions:

> *The purpose of excluding compromises and DOCAs from the operation of the offence provisions is to avoid undermining these mechanisms as legitimate options to rescue, reorganise or restructure financial distressed businesses.*[220]

In addition, the safe harbour Explanatory Memorandum also highlighted that the reason for introducing the safe harbour provisions was to recognise that the insolvent trading provisions can 'result in the unnecessary liquidation of companies that could otherwise be successfully restructured and continue to operate'.[221]

It is not clear to us why the safe harbour protections do not also operate as a carve-out to the obligations in section 596AC of the Act and are not considered a 'legitimate option to rescue, reorganise or restructure a financially distressed business'. We recommend that, just as cross references to the creditor defeating dispositions were included in the safe harbour provisions, so should section 596AC of the Act.

218 Wellard submission, p 5.

219 Wellard submission, p 3.

220 Wellard submission, p 3; Explanatory Memorandum to the Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018, [2.56].

221 Explanatory Memorandum to the Corporations Amendment (Strengthening Protections for Employee Entitlements) Bill 2018, [2.56]. Explanatory Memorandum to the Treasury Laws Amendment (2017 Enterprise Incentives No. 2) Bill 2017, [1.7]-[1.10].

14.7 Application of safe harbour to directors of NFPs

A further matter raised for the Panel's consideration was the availability of safe harbour to directors of NFPs. The AICD/BCA submitted it had received feedback that there is some uncertainty regarding the way in which safe harbour applies to NFP directors.[222] The AICD/BCA submission noted that the 'patchwork' nature of the state and Commonwealth legislation which regulates NFPs, as well as the requirements imposed by the ACNC,[223] has contributed to this lack of certainty.[224] It was suggested there would be benefit in the ACNC and ASIC issuing joint guidance to clarify, at least for those entities incorporated under the Act, that 'safe harbour is a potential protection available to them'.

The Panel acknowledges that NFPs, and their directors, are subject to a multi-faceted regulatory regime, which may give rise to some complexities for directors who seek to ascertain the scope and content of their duties and obligations. In the Panel's view, it is intended for safe harbour to be available to directors of NFPs. This is made clear in Part 1.6 of the Act, concerning the Act's interaction with the *Australian Charities and Not-for-profits Commission Act 2012* (Cth). Section 111L lists provisions of the Act which are not applicable to bodies corporate registered under the *Australian Charities and Not-for-profits Commission Act 2012* (Cth). While the general directors' duties in sections 180-183 are referred to in that section, there is no reference to the duty to prevent insolvent trading in section 588G, or safe harbour provisions. As such, it can be inferred that Parliament intended for sections 588G and 588GA to apply to directors of NFPs which are subject to regulation by the Act.

It is possible the lack of certainty identified by the AICD/BCA stems in part from issues associated with a wholesale application of the concept of 'solvency', as defined in the Act, to NFPs. The operations of NFPs are distinct from those of ordinary proprietary companies. For example, NFPs may be operating with little to no capital, and may be reliant on grants to fund their continuing operations. As such, the Panel sees benefit in the unique circumstances of NFPs being given closer consideration as part of a holistic review of the broader insolvency law framework.

222 AICD/BCA submission, p 8.

223 Notably, Governance Standard 5 concerning 'Duties of Responsible Persons', which requires charities to take reasonable steps to make sure certain duties apply to Responsible Persons and that those persons follow them. It includes a duty not to allow the charity to operate while it is insolvent.

224 AICD/BCA submission, p 8.

PART V
HOLISTIC REFORM

15. Holistic Reform

A consistent theme through this Report is the call for a holistic review of Australia's insolvency laws.

Set out in this section are some compelling reasons for a comprehensive review of Australia's insolvency laws, from an economic, legal, and social perspective.

15.1 Examples of inconsistencies and conflicts within current law

If one of the main drivers behind implementation of the safe harbour provisions is to remove in certain circumstances, the threat of directors being personally liable for the debts of the company, what efficacy can those provisions have when other legislative provisions continue to impose liability on the director in the same circumstances? Some examples of the inconsistency of approach are set out below.

For the Panel, it is a powerful argument for holistic reform, where public policy imperatives can be considered and applied consistently. Other than where stated below, we are cautious about recommending wholesale changes to insolvency laws to rectify the apparent lack of statutory compatibility, without the wider impact on business practice and the economy being properly assessed. A piecemeal approach will only lead to further inconsistencies.

a) Section 588FA – unfair preferences

While safe harbour can be used without the knowledge of creditors, there are occasions where directors may need the support of key creditors to implement their restructuring plans. To obtain creditor support, management of a distressed company may provide financial information to a creditor which evidences a suspicion of the company's insolvency. This in turn may create evidence of a creditor's knowledge to be used in an unfair preference claim by a liquidator, should the company enter a formal process. Accordingly, a creditor will often be reluctant to engage in such discussions, which may frustrate implementation of the restructuring plan. Some creditors submitted they should be released from remitting preference payments received from a company during a period where its directors are relying on safe harbour.

However, unfair preferences, along with antecedent transactions, are a significant contributor to the way in which liquidations are funded, which in their absence, will need to be funded by other means. That raises a question as to the role of the state and the private profession in the insolvency system, what the insolvency profession should be asked to do in winding up companies, and who bears the cost of that. Accordingly, it is the Panel's view that any removal or tweaking of unfair preferences requires further consideration (from a public policy and practical perspective) as to how liquidations could be funded in their absence.

b) Section 588FGA – directors to indemnify Commissioner of Taxation if certain payments set aside

Under section 588FGA of the Act, directors may be liable to indemnify the ATO where the ATO has been ordered to repay an amount received by the company as an unfair preference. This means that

where a company makes a payment to the ATO in circumstances where the directors are seeking to rely on safe harbour, and the course of action that the directors were pursuing ultimately fails and the company is wound up, the director ends up bearing the risk of such payment being found to be an unfair preference. In other words, even though the safe harbour provisions applied during that time, the director may still be liable.

Rather than risk this possible exposure, a director may choose to wind the company up rather than strive for a possible better outcome for the company through a restructuring.

c) Director Penalty Notices and resulting personal liability

Where a company does not pay in full its obligations relating to its PAYG withholding, GST, and/or its SGC, the ATO may seek to recover the unpaid amounts from a director of the company personally via issuance of a Director Penalty Notice (**DPN**).

The DPN regime is an onerous one for directors and, from our consultation process, is only starting to be more broadly understood. While on some level, it appears unrelated to the safe harbour reforms, from a policy perspective, it looks to be inconsistent with the principles behind the safe harbour provisions. In our consultations, many stakeholders raised it as another reason why the safe harbour provisions are not resonating with SMEs. However, the problems that arise from the intersection of DPNs with a company in safe harbour are not limited to SMEs.

For example, where a new director is appointed to a company, that director has 30 days to ensure that all unpaid PAYG, GST and SGC is paid in full, or otherwise (unless the company appoints an administrator, begins to be wound up or appoints a small business restructuring practitioner), the director is liable for the unpaid amounts. That director remains liable for historical unpaid amounts, even if they resign.

It is not difficult to imagine circumstances where a director has no option but to place the company into administration (notwithstanding that such a course of action may be worse for the company and its creditors).

Separately, if a director is already liable for ATO debts (because their company is behind in payments), then there may be little incentive to engage substantively with the safe harbour provisions. This may seem a little trite, but because the ATO is one of the main debtors of many SMEs and medium-sized companies, directors may not feel incentivised to lodge their taxes, or seek the counsel of an appropriately qualified adviser, if it is not going to remove a large part of their (already existing) personal liability.

If the purpose behind the safe harbour provisions is to encourage companies to seek advice early and put their companies in the best possible position for a viable future (including improving the books and records, lodging taxes and paying employee entitlements), then DPNs act as a disincentive and, in practice, may be counterproductive to those aims.

d) Section 596AC – relevant agreements or transactions that avoid employee entitlements

The implications of section 596AC are considered in more detail in section 14.6 of this Report.

From a policy perspective, section 596AC is at odds with one of the stated purposes of section 588GA, being to avoid premature appointments. The Law Council also identified this in their submission, asking whether '*the new employee entitlement-defeating voidable transaction provisions and the broader creditor-defeating disposition provisions are better suited to achieving the policy*

goals behind the introduction of the insolvent trading prohibition … to protect employees and creditors?'[225]

The Panel is of the view that this is one inconsistency that can be readily addressed on an individual basis, by including the safe harbour provisions as a legislative carve-out to section 596AC.

15.2 Alternatives to the underlying insolvent trading prohibition: a 'business judgement rule' model

As noted in section 8.2 above, several submissions received by the Panel queried whether the safe harbour provisions could be made more fit-for-purpose if they were aligned with, or replaced, the business judgment rule in section 180(2) of the Act (or something like it). The points highlighted in those submissions included:

- the need to strike a better balance between the threat of personal liability for insolvent trading and supporting directors' decision-making when a company is experiencing financial distress
- the lack of clarity concerning the interaction between the safe harbour provisions and the general directors' duties in Part 2D.1 of the Act, and the confusion surrounding the application of directors' duties in an insolvency context, and
- finding ways to incentivise better behaviour and decision-making by directors, in particular, during periods of financial distress.

The business judgment rule is, at present, concerned exclusively with the general directors' duties in Part 2D.1 of the Act, and specifically with the duty in section 180 which requires a director or other officer of a corporation to exercise their powers and discharge their duties with care and diligence. The note to section 180(2) stipulates that the business judgment rule only operates in relation to the duty in section 180 and its equivalents at common law and equity. It does not operate in relation to duties under any other provisions of the Act or under any other laws. We have extracted section 180 in full below.

Section 180 – Care and Diligence – Civil Obligation Only

Care and diligence — directors and other officers

(1) A director or other officer of a corporation must exercise their powers and discharge their duties with the degree of care and diligence that a reasonable person would exercise if they:
  (a) were a director or officer of a corporation in the corporation's circumstances; and
  (b) occupied the office held by, and had the same responsibilities within the corporation as, the director or officer.

Note: This subsection is a civil penalty provision (see section 1317E).

Business judgment rule

(2) A director or other officer of a corporation who makes a business judgment is taken to meet the requirements of subsection (1), and their equivalent duties at common law and in equity, in respect of the judgment if they:
  (a) make the judgment in good faith for a proper purpose; and
  (b) do not have a material personal interest in the subject matter of the judgment; and

225 Law Council submission, p 4.

(c) inform themselves about the subject matter of the judgment to the extent they reasonably believe to be appropriate; and
(d) rationally believe that the judgment is in the best interests of the corporation.

The director's or officer's belief that the judgment is in the best interests of the corporation is a rational one unless the belief is one that no reasonable person in their position would hold.

Note: This subsection only operates in relation to duties under this section and their equivalent duties at common law or in equity (including the duty of care that arises under the common law principles governing liability for negligence) — it does not operate in relation to duties under any other provision of this Act or under any other laws.

(3) In this section:

business judgment means any decision to take or not take action in respect of a matter relevant to the business operations of the corporation.

The business judgment rule operates as a 'rebuttable presumption',[226] which is 'enlivened' by a director establishing each of the 4 criteria contained in section 180(2).[227] A director who establishes those criteria will be taken to have met the requirements of the duty of care and diligence in section 180(1) (and its equivalents at common law and equity). It includes the criterion in section 180(2)(d) that the director 'rationally believed' the judgment was in the best interests of the corporation. This requires a subjective assessment of whether a director's process of reasoning was rational, followed by an objective assessment of whether the relevant belief was one no reasonable person in the director's position would have held.[228]

The business judgment rule was introduced into the Act by the *Corporate Law Economic Reform Program Act 1999* (Cth). It is clear, when having regard to the Explanatory Memorandum of the aforementioned legislation,[229] that there are conceptual similarities between the business judgment rule and the safe harbour provisions which commenced operation almost 2 decades later. For example, the Explanatory Memorandum stated:

> In general terms a statutory business judgment rule will offer directors a *safe harbour* from personal liability in relation to honest, informed and rational business judgments.[230]

Notwithstanding the conceptual similarities, Parliament has maintained the narrowed scope of operation of the business judgment rule to the director's duty of care and diligence.[231] Although, in the years since its enactment, there have been calls for the business judgment rule (or something like

226 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998 *(*Cth), [6.10].

227 *Australian Securities and Investments Commission v Mitchell (No 2)* (2020) 382 ALR 425, [1425] (Beach J). His Honour also held that the 'legal and evidentiary onus' is on a defendant director to establish the criteria in section 180(2). His Honour observed that 'each of the criteria is within the purview, personal knowledge of and proof by the defendant director, suggesting that it was the statutory intent that he bears the relevant legal and evidentiary onus' (at [1425]).

228 Ford, Austin and Ramsay's Principles of Corporations Law (LexisNexis at July 2020) at [8.310.24], referring to the decision of Beach J in Australian Securities and Investments Commission v Mariner Corp (2015) 241 FCR 502.

229 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998 (Cth).

230 Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998 (Cth), [6.1]. [6.3] and [6.4] (original emphasis).

231 The Explanatory Memorandum to the Corporate Law Economic Reform Program Bill 1998 (Cth) stated with respect to the business judgment rule that '[t]he proposed provision does not apply, for example, to business judgments made by directors in the context of insolvent trading or in relation to misstatements in a prospectus or takeover document. These are discrete areas that are each regulated by a separate liability regime (at [6.8]).

it) to be extended to the insolvent trading regime in the Act.[232] The reigniting of these calls in the submissions received by this Panel highlight the utility of this matter being reconsidered as part of a holistic review of the insolvent trading framework.

15.3 Alternatives to the underlying insolvent trading prohibition: wrongful trading

A number of submissions referred to a wrongful trading regime as a potential replacement of the current insolvent trading framework in the Act (and noted in particular the United Kingdom and Singapore as examples of jurisdictions which have adopted such a regime).

Whilst there are differences in the provisions in force in the United Kingdom and Singapore, the key elements of those 'wrongful trading' models can be distilled as follows:

- a company becomes insolvent
- the company continued incurring debts or liabilities while it was insolvent, or became insolvent as a result of incurring those debts or liabilities
- a director is liable if they knew or ought to have known that trading was 'wrongful' (that is, due to the company being unable to meet those debts or liabilities).[233]

Under the United Kingdom model, there is a focus on whether there was 'no reasonable prospect' that the company would avoid entering insolvency. A director will not be liable if they took steps with a view to minimising potential losses to creditors, once he or she concluded there was no reasonable prospect the company would avoid becoming insolvent. Most submissions to the Panel that raised this topic were supportive of consideration being given to the adoption of such a regime in Australia, although some who had practiced in the United Kingdom spoke of difficulties with such a regime in practice.

Wellard submitted that a wrongful trading provision would be a substantial improvement on the duty to prevent insolvent trading in section 588G because it 'does not rely on the vexed element of 'actual insolvency' but rather, more simply, imposes personal liability on directors where a company incurs a debt or liability in circumstances where there is no reasonable basis to expect that the obligation will be satisfied'.[234]

The AICD/BCA challenged the Panel to consider whether 'increasing the threshold' of the duty in section 588G to 'wrongful trading' in line with the United Kingdom model warrants further analysis, noting the threshold for director liability in the United Kingdom is higher than that under section 588G, which requires 'only that there was reasonable suspicion in the mind of the director that the company was insolvent'.[235] The TMA commented that it might be timely to explore with the community whether insolvent trading ought to be replaced with wrongful trading, 'which focus[es] on the propriety of the decision according to community expectations'.[236]

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232 See Leanne Whitechurch, 'Should the law on insolvent trading be reformed by introducing a defence akin to the business judgment rule?' (2009) 17 *Insolvency Law Journal* 25, 26-27.

233 We have deliberately simplified what are quite extensive provisions. For more detail see *Insolvency Act 1986* (UK), section 214 and *Insolvency, Restructuring and Dissolution Act 2018* (Singapore), s 239. For a more detailed overview of the Singapore model, as well as some consideration of the United Kingdom model, see Stacey Steele, Ian Ramsay and Miranda Webster, 'Insolvency law reform in Australia and Singapore: Directors' liability for insolvent trading and wrongful trading' (2019) 28(3) *International Insolvency Review* 363.

234 Wellard submission, p 2.

235 AICD/BCA submission, p 3.

236 TMA submission, p 13.

The Law Council's submission was along similar lines and noted that a wrongful trading prohibition could operate in tandem with 'the existing suite of directors' duties and antecedent transaction provisions (including in particular those dealing with creditor defeating dispositions and transactions avoiding payment of employee entitlements)'. The Law Council submitted this would facilitate the dual objectives of protecting creditors and 'effectively facilitating and promoting corporate rescue in appropriate cases'.[237]

ARITA provided a different view, commenting that there was 'limited support for the repeal of the insolvent trading and safe harbour provisions' among their members and that there were 'very mixed views about whether a 'wrongful trading' framework of the kind adopted in the United Kingdom would be a better approach'.[238]

It is beyond the scope of this Review to consider the different models of wrongful trading around the globe, or to consider whether Australia's prohibition on insolvent trading should be replaced with such a model. The adoption of a wrongful trading model in Australia would have significant ramifications for the insolvent trading regime, the broader corporate governance framework provided for in the Act, and related regulatory mechanisms. As flagged in the Law Council's submission, a wrongful trading prohibition would intersect with general directors' duties (including those contained in Part 2D.1 of the Act). It would also interact with the external administration framework in Chapter 5 of the Act. Accordingly, if such a proposal is to be considered, it should be the subject of in-depth consideration and consultation with key stakeholders including creditors, directors, regulators and advisers.

While the safe harbour provisions are, in the Panel's view, an enhancement to the prohibition on insolvent trading and how it operates in practice, there are still significant queries about the underlying effectiveness of the prohibition, and its interaction with corporate governance, risk allocation and other legislative obligations of directors. Those difficulties arise because of the starting position of the duty: directors are liable for all insolvent trading, unless carve-outs or defences apply.

The appropriateness of that base position (from a policy perspective) is worthy of being questioned. To the extent a 'wrongful trading' model can achieve similar policy objectives while also clarifying and simplifying the concept of insolvent trading from the perspective of directors, is, at least on its face, appealing. However, its appropriateness within the Australian jurisdiction must be considered.

15.4 The call for holistic review

The Panel's terms of reference asked us to consider, among other things, any particular issues experienced by directors of SMEs when engaging with financial distress. We have addressed a number of these in our analysis of the safe harbour provisions set out above, but perhaps one of the most significant issues is Australia's insolvency laws themselves. For many non-lawyers and non-insolvency specialists (and indeed, many lawyers and insolvency specialists too), it is an impenetrable quagmire that is scary, complex and unknown.

ARITA and TMA submissions in particular, point to their views that Australia's bankruptcy, restructuring, insolvency and turnaround regimes are among the most complex in the world. For corporations, insolvency processes are contained, and must be navigated by users, in:

- Chapter 5 of the Act
- Schedule 2 – Insolvency Practice Schedule (Corporations)
- the Corporations Regulations, and

237 Law Council submission, p 11.
238 ARITA submission, p 33.

- Insolvency Practice Rules (Corporations) 2016 (Cth).

To illustrate how layered and complex the provisions have become, consider that the new safe harbour carve-out for the SBR reforms is located in a part of the Act labelled section '588***GAAB***'.

We would welcome a review that considers how to best update Australia's insolvency laws for the 2020s and beyond. As we noted in the Executive Summary, one of the drivers of the Harmer Report was the acknowledgment that economic and social change are factors that indicate a need for review of insolvency law and procedure.[239] There has been significant economic and social change in Australia since the publication of the Harmer Report in 1988. The way in which capital (both public and private) is sourced, and the globalisation of debt and equity capital markets, are just some illustrations of the ways in which Australia in 2021 is a very different place to Australia in the early 1990s. During the intervening period, Australia also adopted the UNCITRAL Model Law on Cross-Border Insolvency. The Model Law is designed to assist signatory states (including Australia) to more effectively manage cross-border insolvencies. The Panel considers that it would be timely to consider the Model Law's impact on and inter-relationship with Australia's insolvency laws (particularly in the context of international trade, and complex cross-border insolvencies).

Without being too prescriptive about what other matters a comprehensive review should consider, it should focus on balancing the competing interests of debtors, creditors, and the wider community. To promote a culture of entrepreneurship, it is necessary to establish benchmarks of acceptable director behavior which the capital markets, and our international trading partners, will support.

Fundamental to such a review is establishing principles with respect to who should bear the financial risk during a corporate restructuring and what is the most effective process of protecting the interests of stakeholders throughout the restructuring. Any review should consider the different challenges faced by companies in the SME and mid markets compared to larger companies. It may be that a 'one size model' does not fit all.

239 Australian Law Reform Commission, General Insolvency Inquiry [1988] ALRC 45, Chapter 7, p 4.

PART VI
RECOMMENDATIONS

16. Recommendations

Recommendation 1

The Panel recommends that section 588GA(1)(a) be amended to include a reference to a person starting to suspect the company is in financial distress (in addition, and as an alternative to, a person starting to suspect that the company may become or be insolvent).

Recommendation 2

The Panel recommends that the safe harbour protections extend to the obligations of directors under section 596AC, and that section 588GA be amended to refer to subsections 596AC(1) and (3).

Recommendation 3

The Panel recommends that section 588GA(1)(b) be amended to specifically refer to debts incurred in the ordinary course of business.

Recommendation 4

The Panel recommends that a plain English 'best practice guide' to safe harbour be developed by Treasury in consultation with key industry groups. The Panel recommends that this guide set out general eligibility criteria for appropriately qualified advisers.

Recommendation 5

The Panel recommends section 588GB be amended, to clarify that:

- if books and records are in a director's possession and control (even if they are not the books and records 'of the company'), and
- those books and records are not provided to the administrator or liquidator at the time of a formal appointment,

then the director will also be prevented from producing those books and records to establish safe harbour in any relevant proceeding.

Recommendation 6

The Panel recommends either the reference to the term 'restructuring' in section 588GA(2) be replaced or the definition of restructuring in section 9 be updated to include a definition of that term for the purpose of section 588GA(2)(e).

Recommendation 7

The Panel recommends that section 588GA(2)(d) be amended by replacing the reference to 'an appropriately qualified entity' with 'one or more appropriately qualified advisers'.

Recommendation 8

The Panel recommends that section 588GA(2)(d) be amended to expressly state that regard may also be had as to whether the *company* is receiving advice from one or more appropriately qualified advisers who have been given sufficient information to provide appropriate advice.

Recommendation 9

The Panel recommends amending subsections 588GA(4)(a) and 588GA(4)(a)(i) to align the wording of those provisions with the wording of the employee entitlement safeguard in Regulation 5.3B.24.

Recommendation 10

The Panel recommends that a finite list of tax reporting obligations be included in subsection 588GA(4)(a)(ii).

Recommendation 11

The Panel recommends the deletion of subsection 588GA(4)(b)(ii).

Recommendation 12

The Panel recommends that a definition of substantial compliance be included in the Act, to assist stakeholders to interpret the requirements of subsection 588GA(4).

Recommendation 13

The Panel recommends that data on safe harbour utilisation be collected and reported upon, as part of the reports received from voluntary administrators and liquidators.

Recommendation 14

The Panel recommends that Treasury commission a holistic in-depth review of Australia's insolvency laws.

Specific guidance suggestions

In addition to Recommendation 4, the Panel strongly supports an update being made to ASIC Regulatory Guide 217 to refer to the insolvent trading prohibition, and the safe harbour provisions, together with general guidance on the operation of the relevant provisions.

PART VII
GLOSSARY AND ANNEXURES

17. Acronyms and Abbreviated terms

Acronym	Term
ACNC	The Australian Charities and Not-for-profits Commission
AQE	Appropriately Qualified Entity
ASIC	Australian Securities & Investments Commission
ATO	Australian Taxation Office
DOCA	Deed of Company Arrangement
DPN	Director Penalty Notice
FEG	Fair Entitlements Guarantee
ITAA	*Income Tax Assessment Act 1997* (Cth)
NFP	Not-for-profit organisation
SBR	Small Business Restructuring
SME	Small and Medium-sized Enterprise
The Act	*Corporations Act 2001* (Cth)

Annexure A: Written Submissions

No.	Entity	Referred to as
1	Cole Corporate	Cole Corporate
2	Law Council of Australia	Law Council
3	Chartered Accountants Australia and New Zealand and CPA Australia	CA ANZ/CPA
4	Australian Restructuring Insolvency and Turnaround Association	ARITA
5	Mark Wellard (University of Technology Sydney)	Wellard
6	Wexted Advisors	Wexted
7	Australian Credit Forum	ACF
8	Australian Small Business and Family Enterprise Ombudsman	ASBFEO
9	King & Wood Mallesons	King & Wood Mallesons
10	Australian Banking Association	ABA
11	Vantage Performance	Vantage
12	Deloitte	Deloitte
13	Turnaround Management Association	TMA
14	McGrathNicol	McGrathNicol
15	Institute of Public Accountants	IPA
16	GSE Capital	GSE Capital
17	Australian Institute of Credit Management	AICM
18	KPMG	KPMG
19	Australian Institute of Company Directors and Business Council of Australia	AICD/BCA
20	Australian Retailers Association	ARA

Annexure B: Consultations undertaken

Date	Entity
10 September 2021	Jason Harris, Mark Wellard and Michael Murray
28 September 2021	Council of Small Businesses Organisations Australia
29 September 2021	Chartered Accountants Australia and New Zealand, CPA Australia and Institute of Public Accountants
30 September 2021	Australian Institute of Company Directors
6 October 2021	International Association of Restructuring, Insolvency & Bankruptcy Professionals
14 October 2021	Restaurant and Catering Association
21 October 2021	Attorney-General's Department
25 October 2021	Turnaround Management Association
26 October 2021	Australian Restructuring Insolvency and Turnaround Association
27 October 2021	Australian Securities and Investments Commission
28 October 2021	Law firm round table discussions with representatives from Allens, Ashurst, Clayton Utz, Corrs Chambers Westgarth, Herbert Smith Freehills and Minter Ellison.
29 October 2021	Wexted Advisors and Vantage Performance

Annexure C: Safe harbour provisions

Section 588GA – safe harbour — taking course of action reasonably likely to lead to a better outcome for the company

Safe harbour

(1) Subsection 588G(2) does not apply in relation to a person and a debt, and subsections 588GAB(1) and (2) and 588GAC(1) and (2) do not apply in relation to a person and a disposition, if:

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

(b) the debt is incurred, or the disposition is made, directly or indirectly in connection with any such course of action during the period starting at that time, and ending at the earliest of any of the following times:

(i) if the person fails to take any such course of action within a reasonable period after that time—the end of that reasonable period;

(ii) when the person ceases to take any such course of action;

(iii) when any such course of action ceases to be reasonably likely to lead to a better outcome for the company;

(iv) the appointment of an administrator, or liquidator, of the company.

Note 1: The person bears an evidential burden in relation to the matter in this subsection (see subsection (3)).

Note 2: For subsection (1) to be available, certain matters must be being done or be done (see subsections (4) and (5)).

Working out whether a course of action is reasonably likely to lead to a better outcome

(2) For the purposes of (but without limiting) subsection (1), in working out whether a course of action is reasonably likely to lead to a better outcome for the company, regard may be had to whether the person:

(a) is properly informing himself or herself of the company's financial position; or

(b) is taking appropriate steps to prevent any misconduct by officers or employees of the company that could adversely affect the company's ability to pay all its debts; or

(c) is taking appropriate steps to ensure that the company is keeping appropriate financial records consistent with the size and nature of the company; or

(d) is obtaining advice from an appropriately qualified entity who was given sufficient information to give appropriate advice; or

(e) is developing or implementing a plan for restructuring the company to improve its financial position.

(3) A person who wishes to rely on subsection (1) in a proceeding for, or relating to, a contravention of subsection 588G(2) bears an evidential burden in relation to that matter.

Matters that must be being done or be done

(4) Subsection (1) does not apply in relation to a person and either a debt or a disposition if:

(a) when the debt is incurred, or the disposition is made, the company is failing to do one or more of the following matters:

(i) pay the entitlements of its employees by the time they fall due;

(ii) give returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the *Income Tax Assessment Act 1997*); and

(b) that failure:

(i) amounts to less than substantial compliance with the matter concerned; or

(ii) is one of 2 or more failures by the company to do any or all of those matters during the 12 month period ending when the debt is incurred;

unless an order applying to the person and that failure is in force under subsection (6).

Note: Employee entitlements are defined in subsection 596AA(2) and include superannuation contributions payable by the company.

(5) Subsection (1) is taken never to have applied in relation to a person and either a debt or a disposition if:

(a) after the debt is incurred, or after the disposition is made, the person fails to comply with paragraph 429(2)(b), or subsection 438B(2), 475(1), 497(4) or 530A(1), in relation to the company; and

(b) that failure amounts to less than substantial compliance with the provision concerned;

unless an order applying to the person and that failure is in force under subsection (6).

(6) The Court may order that subsection (4) or (5) does not apply to a person and one or more failures if:

(a) the Court is satisfied that the failures were due to exceptional circumstances or that it is otherwise in the interests of justice to make the order; and

(b) an application for the order is made by the person.

Definitions

(7) In this section:

better outcome, for the company, means an outcome that is better for the company than the immediate appointment of an administrator, or liquidator, of the company.

evidential burden, in relation to a matter, means the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist.

Section 588GB – Information or books not admissible to support the safe harbour if failure to permit inspection etc.

When books or information not admissible for the safe harbour

(1) If, at a particular time:

(a) a person fails to permit the inspection of, or deliver, any books of the company in accordance with:

(i) a notice given to the person under subsection 438C(3), section 477 or subsection 530B(4); or

(ii) an order made under section 486; or

(iii) subsection 438B(1), paragraph 453F(1)(c), section 453G or subsection 477(3) or 530A(1); or

(b) a warrant is issued under subsection 530C(2) because the Court is satisfied that a person has concealed, destroyed or removed books of the company or is about to do so;

those books, and any secondary evidence of those books, are not admissible in evidence for the person in a relevant proceeding.

Note: For subparagraph (a)(i), a liquidator could give such a notice if this is necessary for winding up the affairs of the company and distributing its property (see paragraph 477(2)(m)).

(2) If, at a particular time, a person fails to give any information about the company in accordance with:

(a) a notice given to the person under section 477; or

(b) paragraph 429(2)(b) or subsection 438B(2) or (3), paragraph 453F(1)(b) or subsection 475(1), 497(4) or 530A(1) or (2);

that information is not admissible in evidence for the person in a relevant proceeding.

Exceptions

(3) However, subsection (1) or (2) does not apply to a person, and a book or information, if:

(a) the person proves that:

(i) the person did not possess the book or information at any time referred to in that subsection; and

(ii) there were no reasonable steps the person could have taken to obtain the book or information; or

(b) each entity seeking to rely on the notice, order, subsection, paragraph or warrant referred to in that subsection fails to comply with subsection (5) in relation to the person; or

(c) an order applying to the person, and the book or information, is in force under subsection (4).

(4) The Court may order that subsection (1) or (2) does not apply to a person, and a book or information, if:

(a) the Court is satisfied that the failures by the person as mentioned in that subsection were due to exceptional circumstances or that it is otherwise in the interests of justice to make the order; and

(b) an application for the order is made by the person.

Notice of effect of this section must be given

(5) An entity that seeks to rely on a notice, order, subsection or warrant referred to in subsection (1) or (2) must set out the effect of this section:

(a) for a notice under subsection 438C(3), section 477 or subsection 530B(4)—in that notice; or

(b) for an order under section 486 or for subsection 438B(3), 477(3) or 530A(2)—in a written notice given to the person when the entity seeks to rely on that order or subsection; or

(c) for a warrant issued under subsection 530C(2)—in a written notice given to the person when the entity seeks to exercise the warrant.

This subsection does not apply to an entity that seeks to rely on paragraph 429(2)(b) or subsection 438B(1) or (2), section 453G or subsection 475(1), 497(4) or 530A(1).

(6) A failure to comply with subsection (5) does not affect the validity of the notice, order, subsection or warrant referred to in subsection (5).

Definitions

(7) In this section:

relevant proceeding means a proceeding:

(a) for, or relating to, a contravention of subsection 588G(2) or 588GAB(1) or (2) or 588GAC(1) or (2); and

(b) in which a person seeks to rely on subsection 588GA(1) or 588GAAA(1).

Example: A proceeding under section 588M.

588WA – safe harbour — taking reasonable steps to ensure company's directors have the benefit of the directors' safe harbour

(1) Subsection 588V(1) does not apply in relation to a corporation that is the holding company of a company, and to a debt, if:

(a) the corporation takes reasonable steps to ensure that either subsection 588GA(1) or 588GAAA(1) (the ***safe harbour provision***) applies in relation to:

(i) each of the directors of the company; and

(ii) the debt; and

(b) the safe harbour provision does so apply in relation to each of those directors and to the debt.

(2) A corporation that wishes to rely on subsection (1) in a proceeding for, or relating to, a contravention of subsection 588V(1) bears an evidential burden in relation to that matter.

(3) In this section:

evidential burden, in relation to a matter, means the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist.

Annexure D: SBR Safe harbour provisions

Section 588GAAB – Safe harbour – companies under restructuring

Safe harbour

(1) Subsection 588G(2) does not apply in relation to a person and a debt incurred by a company if the debt is incurred:
  (a) during the restructuring of the company; and
  (b) in the ordinary course of the company's business, or with the consent of the restructuring practitioner or by order of the Court.

(2) A person who wishes to rely on subsection (1) in a proceeding for, or relating to, a contravention of subsection 588G(2) bears an evidential burden in relation to that matter.

When the safe harbour does not apply

(3) Subsection (1) is taken never to have applied in relation to a person and a debt in the circumstances prescribed by the regulations for the purposes of this subsection.

Definitions

(4) In this section: evidential burden, in relation to a matter, means the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist.

Section 500AA – Eligibility Criteria for the Simplified Liquidation Process

(1) The eligibility criteria for the simplified liquidation process are met in relation to a company if:
  (a) a triggering event occurs in relation to the company; and
  (b) subsection 497(4) (report on company's business affairs etc.) and section 498 (declaration of eligibility for simplified liquidation process) have been complied with, or are taken to have been complied with, in relation to the company; and
  (c) the company will not be able to pay its debts in full within a period not exceeding 12 months after the day on which the triggering event occurs; and
  (d) if the regulations prescribe a test for eligibility based on the liabilities of the company — that test is satisfied on the day on which the triggering event occurs; and
  (e) no person who:
    (i) is a director of the company; or
    (ii) has been a director of the company within the 12 months immediately preceding the day on which the triggering event occurs;

  has been a director of another company that has undergone restructuring or been the subject of a simplified liquidation process within a period prescribed by the regulations, unless exempt under regulations made for the purposes of subsection (2) of this section; and

(f) the company has not undergone restructuring or been the subject of a simplified liquidation process within a period prescribed by the regulations, unless exempt under regulations made for the purposes of subsection (2) of this section; and

(g) the company has given returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the *Income Tax Assessment Act 1997*).

(2) The regulations may prescribe:

(a) tests for eligibility based on the liabilities of companies for the purposes of paragraph (1)(d); and

(b) circumstances in which the directors of companies are exempt from the requirement in paragraph (1)(e); and

(c) circumstances in which companies are exempt from the requirement in paragraph (1)(f).

Regulation 5.3B.24

This regulation is satisfied in relation to a company under restructuring if:

(a) the company has:

(i) paid the entitlements of its employees that are payable; and

(ii) given returns, notices, statements, applications or other documents as required by taxation laws (within the meaning of the Income Tax Assessment Act 1997); or

(b) the company is substantially complying with the matter concerned.

Note: Employee entitlements are defined in subsections 596AA(2) and (3) of the Act and include superannuation contributions payable by the company.

Annexure E: Relevant agreements or transactions that avoid employee entitlements provision

Section 596AB - Relevant Agreements or Transactions that Avoid Employee Entitlements — Offences

Offences of entering into relevant agreement or transaction

(1) A person contravenes this subsection if the person enters into a relevant agreement or a transaction with the intention of, or with intentions that include the intention of:
  (a) avoiding or preventing the recovery of the entitlements of employees of a company; or
  (b) significantly reducing the amount of the entitlements of employees of a company that can be recovered.

Note: A contravention of this subsection is an offence (see subsection 1311(1)).

(1A) A person contravenes this subsection if:

  (a) the person enters into a relevant agreement or a transaction; and

  (b) the person is reckless as to whether the relevant agreement or the transaction will:

    (i) avoid or prevent the recovery of the entitlements of employees of a company; or

    (ii) significantly reduce the amount of the entitlements of employees of a company that can be recovered.

Offences of causing company to enter into relevant agreement or transaction

(1B) A person contravenes this subsection if:
  (a) the person is an officer of a company; and
  (b) the person causes the company to enter into a relevant agreement or a transaction; and
  (c) the person does so with the intention of, or with intentions that include the intention of:
    (i) avoiding or preventing the recovery of the entitlements of employees of the company; or
    (ii) significantly reducing the amount of the entitlements of employees of the company that can be recovered.

Note: A contravention of this subsection is an offence (see subsection 1311(1)).

(1C) A person contravenes this subsection if:
  (a) the person is an officer of a company; and
  (b) the person causes the company to enter into a relevant agreement or a transaction; and
  (c) the person is reckless as to whether the relevant agreement or the transaction will:
    (i) avoid or prevent the recovery of the entitlements of employees of the company; or
    (ii) significantly reduce the amount of the entitlements of employees of the company that can be recovered.

Note: A contravention of this subsection is an offence (see subsection 1311(1)).

Application of offence provisions

(2) Subsections (1) and (1A) apply even if the company is not a party to the relevant agreement or the transaction.

(2A) Subsections (1), (1A), (1B) and (1C) apply even if:

(a) the relevant agreement or the transaction is approved by a court; or

(b) the relevant agreement or the transaction has not had the effect or effects mentioned in paragraph (1)(a) or (b), (1A)(b), (1B)(c) or (1C)(c), as the case may be; or

(c) despite the relevant agreement or the transaction, the entitlements of the employees of the company are recovered.

(2B) However, subsections (1), (1A), (1B) and (1C) do not apply if the relevant agreement or the transaction is, or is entered into under:

(a) a compromise or arrangement between the company and its creditors or a class of its creditors, or its members or a class of its members, that is approved by a Court under section 411; or

(b) a deed of company arrangement executed by the company; or

(c) a restructuring plan made by the company.

Note: A defendant bears an evidential burden in relation to the matters in this subsection (see subsection 13.3(3) of the Criminal Code).

(2C) Subsections (1A) and (1C) do not apply if a liquidator or provisional liquidator of the company causes the relevant agreement or the transaction to be entered into in the course of winding up the company.

Note: A defendant bears an evidential burden in relation to the matters in this subsection (see subsection 13.3(3) of the Criminal Code).

(3) A reference in this section to a ***relevant agreement or a transaction*** includes a reference to:

(a) a relevant agreement and a transaction; and

(b) a series or combination of:

(i) relevant agreements or transactions; or

(ii) relevant agreements; or

(iii) transactions.

Note: A relevant agreement is an agreement, arrangement or understanding (see the definition of ***relevant agreement*** in section 9).

Section 596AC - Relevant Agreements or Transactions that Avoid Employee Entitlements — Civil Contraventions

Entering into relevant agreement or transaction

(1) A person contravenes this subsection if:
  (a) the person enters into a relevant agreement or a transaction (within the meaning of subsection 596AB(3)); and
  (b) the person knows, or a reasonable person in the position of the person would know, that the relevant agreement or the transaction is likely to:
    (i) avoid or prevent the recovery of the entitlements of employees of a company; or
    (ii) significantly reduce the amount of the entitlements of employees of a company that can be recovered.

Note: This subsection is a civil penalty provision (see section 1317E).

(2) A person who is involved in a contravention of subsection (1) contravenes this subsection.

Note 1: Section 79 defines ***involved***.

Note 2: This subsection is a civil penalty provision (see section 1317E).

Causing company to enter into relevant agreement or transaction

(3) A person contravenes this subsection if:
  (a) the person is an officer of a company; and
  (b) the person causes the company to enter into a relevant agreement or a transaction (within the meaning of subsection 596AB(3)); and
  (c) the person knows, or a reasonable person in the position of the person would know, that the relevant agreement or the transaction is likely to:
    (i) avoid or prevent the recovery of the entitlements of employees of the company; or
    (ii) significantly reduce the amount of the entitlements of employees of the company that can be recovered.

Note: This subsection is a civil penalty provision (see section 1317E).

(4) A person who is involved in a contravention of subsection (3) contravenes this subsection.

Note 1: Section 79 defines involved.

Note 2: This subsection is a civil penalty provision (see section 1317E).

Application of contravention provisions

(5) Subsections (1) and (2) apply even if the company is not a party to the relevant agreement or the transaction.
(6) Subsections (1), (2), (3) and (4) apply even if:
  (a) the relevant agreement or the transaction is approved by a court; or
  (b) the relevant agreement or the transaction has not had the effect or effects mentioned in paragraph (1)(b) or (3)(c), as the case may be; or
  (c) despite the relevant agreement or the transaction, the entitlements of the employees of the company are recovered.
(7) However, subsections (1), (2), (3) and (4) do not apply if:

(a) the relevant agreement or the transaction is, or is entered into under:
  (i) a compromise or arrangement between the company and its creditors or a class of its creditors, or its members or a class of its members, that is approved by a Court under section 411; or
  (ii) a deed of company arrangement executed by the company; or
  (iii) a restructuring plan made by the company; or
(b) a liquidator or provisional liquidator of the company causes the relevant agreement or the transaction to be entered into in the course of winding up the company.

(8) A person who wishes to rely on subsection (7) in a proceeding for, or relating to, a contravention of subsection (1), (2), (3) or (4) bears an evidential burden in relation to that matter.

Proceedings may be begun only after liquidator appointed

(9) Proceedings under section 1317E for a declaration of a contravention of this section may only be begun after a liquidator has been appointed to the company.

Linked debts

(10) If a person contravenes this section by incurring a debt (within the meaning of section 588G), the incurring of the debt and the contravention are linked for the purposes of this Act.

Linked dispositions

(10A) If there is a contravention of this section involving a disposition of property of a company that is voidable under subsection 588FE(6B), the disposition and the contravention are linked for the purposes of this Act.

(11) In this section: ***evidential burden***, in relation to a matter, means the burden of adducing or pointing to evidence that suggests a reasonable possibility that the matter exists or does not exist.

Annexure F: Consultation paper

Review of the insolvent trading safe harbour

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Consultation Process

Request for feedback and comments

Closing date for submissions: 01 October 2021

Email	SafeHarbourReview@treasury.gov.au
Mail	• Market Conduct Division • The Treasury • Langton Crescent • PARKES ACT 2600
Enquiries	Enquiries can be initially directed to SafeHarbourReview@treasury.gov.au

The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Review of the insolvent trading safe harbour

Overview

In 2017, Parliament enacted the *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Act 2017*. The amendments introduced a safe harbour for company directors from personal liability for insolvent trading if the company is undertaking a restructure.

The aim of the safe harbour reforms is to promote a culture of entrepreneurship by providing breathing space for distressed businesses to facilitate restructuring their affairs and continuing to do business. The safe harbour encourages directors to seek advice earlier on how to restructure and save financially distressed, but viable companies, rather than entering into administration or liquidation prematurely to avoid personal liability.

As part of the 2021-22 Budget, the Government announced that it would commence an independent review into the insolvent trading safe harbour, to ensure that the safe harbour provisions remain fit for purpose and its benefits can extend to as many businesses as possible.

To support this commitment, an independent panel has been appointed to undertake the review. The review will take place for a three-month period, concluding in November 2021. Following the completion of the review, the review panel will provide a written report to the Government, as specified in the review's terms of reference.

Background to the safe harbour reforms

Australia's insolvent trading laws impose a duty on company directors to prevent a company from trading while insolvent. Under section 588G of the *Corporations Act 2001* (the Corporations Act), a director of a company may be personally liable for debts incurred by the company if at the time the debt is incurred there are reasonable grounds to suspect that the company is insolvent. Breaching these provisions can result in civil and criminal penalties against the company's directors.

Prior to the passage of the reforms, it had been suggested that the threat of action under insolvent trading provisions was encouraging directors of distressed companies to resolve the companies enter formal administration, instead of pursuing other restructuring opportunities, even where continuation of the business outside formal administration may be more appropriate. In its 2015 report, 'Business Set-up, Transfer and Closure', the Productivity Commission noted that:

> *The threat of Australia's insolvent trading laws, combined with uncertainty over the precise moment of insolvency has long been identified as a driver behind companies entering voluntary administration, sometimes prematurely.*

To address this, the Commission recommended that a safe harbour from insolvent trading liability be established, to allow directors to make decisions relating to the restructuring of the company without fear of personal liability. This would also enable directors to retain control of the company, rather than giving up control to an external administrator.

On 19 September 2017, following passage of the *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Act 2017*, reforms to establish the insolvent trading safe harbour came into effect.

Operation of the safe harbour defence to insolvent trading

At their core, the reforms provide directors with a safe harbour defence from the civil insolvent trading provisions of section 588G(2) of the Corporations Act.

When the safe harbour defence applies, directors will not be personally liable for debts incurred while the company was insolvent where it can be shown that they were developing or taking a course of action that at the time was reasonably likely to lead to a better outcome for the company than proceeding to immediate administration or liquidation.

The reforms acknowledge that a course of action that is reasonably likely to lead to a better outcome for the company may vary on a case-by-case basis. The provisions are deliberately flexible as to what constitutes a course of action. They identify a number of factors that could be considered in determining if such a course of action was taken. These include whether the company directors:

- kept themselves informed about the company's financial position
- had taken steps to prevent misconduct by officers and employees of the company that could adversely affect the company's ability to pay all its debts
- had taken appropriate steps to ensure the company maintained appropriate financial records
- obtained advice from an appropriately qualified adviser, and
- had been taking appropriate steps to develop or implement a plan to restructure the company to improve its financial position.

The flexibility embedded into the safe harbour provisions is designed to encourage its uptake, including among SMEs (who might not have the resources to meet more prescriptive requirements).

The safe harbour provisions include rules around when the safe harbour protection is available to directors. The safe harbour is not available if the company has failed, within the previous 12 months, to substantially comply with:

- its obligation to pay its employees (including their superannuation), and
- its tax reporting obligations.

The protections provided as part of the safe harbour defence do not extend beyond the civil liability set out in section 588G(2). Directors must continue to comply with all their other legal obligations, such as their director's duties, which is intended to protect against misuse. The safe harbour does not extend to criminal liability for insolvent trading, noting that this requires dishonest conduct by directors.

Assessing the impact of the safe harbour

Section 588HA of the Corporations Act requires that the Minister cause an independent review of the impact of the availability of the safe harbour, including on the conduct of directors, and the interests of creditors and employees.

When assessing their impact, it should be noted that the safe harbour provisions have only been in effect for a relatively short period. Also, the confidential nature of company restructuring that may have taken place under the safe harbour protection limits the availability of quantitative data, further emphasising the importance of stakeholder submissions to this process.

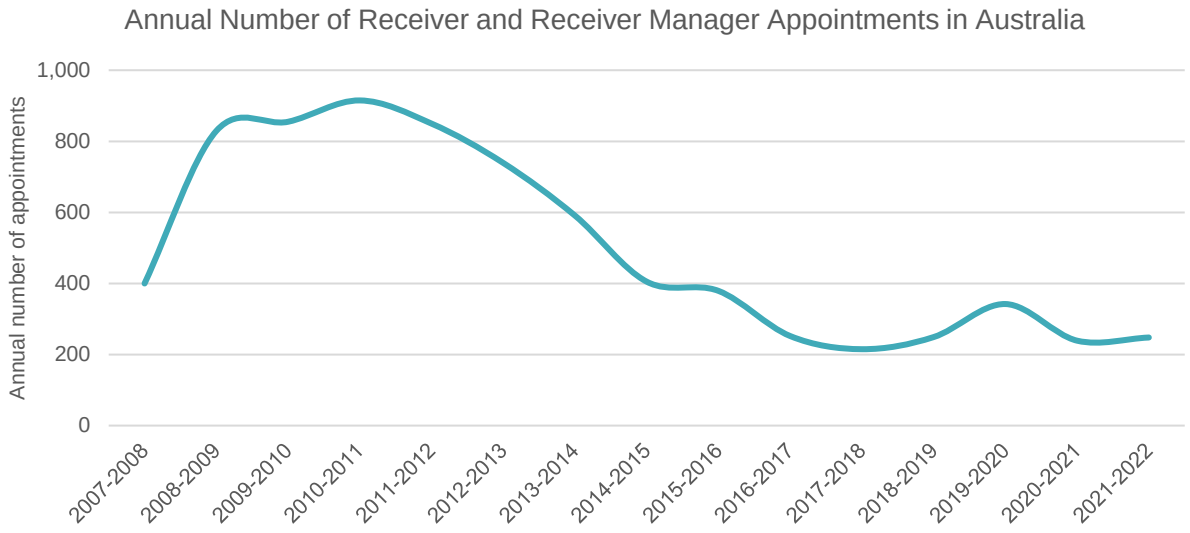
Noting these challenges, the review seeks feedback from stakeholders who may have experience in corporate distress and turnaround, including the degree to which they have engaged with the safe harbour reforms, both from an adviser and any potential subsequent administrator or liquidator point of view, and (for those involved in companies whose directors utilised the safe harbour defence) their experience engaging with the reforms in practice. The perspective of creditors and other stakeholders is also sought.

The overarching intent is to determine the effectiveness of the reforms, and whether they are fit for purpose in enabling company turnaround, and promoting a culture of entrepreneurship and innovation.

Questions for discussion

1. Are the safe harbour provisions working effectively?
2. What impact has the availability of the safe harbour had on the conduct of directors?
3. What impact has the availability of the safe harbour had on the interests of creditors and employees?
4. How has the safe harbour impacted on, or interacted with, the underlying prohibition on insolvent trading?
5. What was your experience with the COVID-19 insolvent trading moratorium, and has that impacted your view or experience of the safe harbour provisions?
6. Are you aware of any instances where safe harbour has been misused?
7. Are the pre-conditions to accessing safe harbour appropriate?
8. Does the law provide sufficient certainty to enable its effective use?
9. Is clarification required around the role of advisers, including who qualifies as advisers, and what is required of them?
10. Is there sufficient awareness of the safe harbour, including among small and medium enterprises?
11. In relation to potential qualified advisors, what barriers or conflicts (if any) limit your engagement with companies seeking safe harbour advice?
12. Are there any other accessibility issues impacting its use?
13. Are there any improvements or qualifications you would like to see made to the safe harbour provisions and/or the underlying prohibition on insolvent trading?

Appendix 3 - Annual Number of Receiver Appointments



Source: Australian Security and Investments Commission, '*Australian Insolvency Statistics: Series 1: Companies entering external administration and controller appointments, January 1999–July 2022*' (Web Page, September 2022) <https://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics-up-to-31-july-2022/insolvency-statistics-series-1-companies-entering-external-administration-and-controller-appointment>

Criteria for registration as a liquidator

1. The current criteria

1.1 Section 20-1 *Insolvency Practice Rule (Corporations) 2016* (**IPS**) provides that a committee who is referred an application for registration as a liquidator must be satisfied:

[…]

*(c) if the applicant wishes to be registered to practise as an external administrator of companies, receiver and receiver and manager—the applicant has, **during the 5 years immediately preceding the day on which the application is made**, been engaged in at least 4,000 hours of relevant employment at senior level;*

*(d) if the applicant wishes to be registered to practise only as a receiver, and receiver and manager—the applicant has, **during the 5 years immediately preceding the day on which the application is made**, been engaged in at least 4,000 hours of relevant employment at senior level;*

(emphasis added)

1.2 RG 258.25 deals with 'senior level' as follows:

Matters that the committee may consider in deciding whether your employment was at a senior level include:

(a) whether your experience was gained when you were a principal in the firm or at a level immediately below that of principal;

(b) whether you reported directly to the external administrator, or to the receiver or receiver and manager (the appointee); and

(c) whether you:

(i) formed opinions and made recommendations to the appointee about strategic and tactical matters, and the financial and potential legal position of the company;

(ii) were directly involved in planning and managing the conduct of the external administration, receivership or receivership and management (including conducting appropriate investigations of the company's business, property, affairs and financial dealings) on behalf of the appointee;

(iii) prepared draft reports to creditors on behalf of the appointee;

(iv) instructed solicitors and evaluated legal advice as directed by the appointee; and

(v) supervised staff who reported through you to the appointee, and had responsibility for allocating these resources.

2. The issue

1.3 While not impossible to achieve, mandating the experience level and hours be completed during the five years immediately preceding the application, is an unnecessary hurdle that will disproportionately affect practitioners who take parental leave. This is especially where:

(a) many family units actively plan to have children in close succession in order to minimise the impact on their career (to keep the period of 'interruption' to a minimum);

(b) primary caregivers often return to work on part-time basis (the criteria calls for applicants to complete 800 hours per year in the proceeding five years, which is completely

achievable for someone who works full time, achievable (but perhaps less so) for someone who takes one year parental leave, but it becomes increasingly difficult for applicants who have multiple children and return to work part time); and

(c) we know, statistically speaking, that women's' trajectories to 'senior levels' is slower than their male counterparts (which, of course, is a separate issue) so the effect of a criteria that disproportionately disadvantages women is it perpetuates the cycle of women trailing men in key leadership roles.

1.4 The Regulatory Guide RG 258 Registered liquidators: Registration, disciplinary actions and insurance requirements (**Regulation**) requires applicants to:

1. tick 'yes' or 'no' to whether they have fulfilled the relevant experience requirements at section 6A of their Application Form 903B; and

2. attach to their Form 903B a completed 'Senior Level Employment History' form, which should include:

(a) A summary of your employment history for the last five years (including names of employers, positions held and dates); and

(b) *Full details demonstrating that you have engaged in 4,000 hours of relevant insolvency experience at a senior level in the five years immediately preceding the day on which you make this application.*

1.5 The Regulation empowers the Committee to exercise discretion in this respect, as RG 258.17 provides:

'*If the committee is not satisfied of one of the following matters, the committee may still decide that you should be registered as a liquidator provided it is satisfied that you would be suitable to be registered if you complied with conditions it specifies. The matters are:*

(a) *that you possess the prescribed qualifications, **experience,** knowledge and abilities;*'

(emphasis added)

1.6 We note, however, that there is no prompt in the Form 903B or the 'Senior Level Employment History Form' for applicants to provide further information regarding why they have ticked 'No'. There is no transparency regarding how the Committee can use this discretion and in which circumstances, or opportunity for the applicant to explain any vitiating factors (eg part-time return to work arrangements) which have meant they have not met the relevant experience criteria and why the Committee should nonetheless approve their application.

3. Current statistics: women liquidators

3.1 The fact that there is, perhaps, degrees of unconscious bias in the path to becoming a liquidator has no bearing unless it negatively impacts growth and diversity in the profession.

3.2 Quarterly statistics released by ASIC, here (see table 4.4 – Registered Liquidators – gender by region), show that there is most certainly an impact (though it may be attributable to a number of factors).

3.3 The statistics from the July 2022 quarter show:

(a) Of the 644 registered liquidators nationally, only 59 of them were female.

(b) In Queensland, there are only 16 female liquidators (out of a total 111).

(c) Concerningly, the annual figures for Queensland show an increase of approximately 6.5% in respect of male liquidators and 0% growth in females over a three-year period (noting that this is bottom line growth and does not account for those leaving the profession).

(d) There are notably no female liquidators in South Australia, the Northern Territory or the Australian Capital Territory.

4. Solution?

1.7 Suggestions to even the playing field:

(a) At a minimum, including a section in the 'Senior Level Employment History' form for applicants to explain any vitiating factors in the context of the experience criteria; or

(b) explicitly state in the Regulation at RG 258.17 that an applicant's caregiving responsibilities may be considered where the applicant has ticked 'no' at section 6A of their Form 903B; or

(c) ideally, removing '*during the 5 years immediately preceding the day on which the application is made*' form IPS s 20-1. This would not 'open the floodgates' and see practitioners who are not across contemporary industry practices becoming Registered Liquidators. Section 20-1 of the IPS requires the Committee to be satisfied that the applicant has the relevant qualifications, experience, knowledge and abilities.

Note prepared by Ann Watson and Georgia Gamble of Hall & Willcox

17 September 2021

Manager
Market Conduct Division
Treasury
Langton Cres
Parkes ACT 2600

Email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam,

Helping Companies Restructure by Improving Schemes of Arrangement:
TMA Australia Submissions on the Consultation Paper

The Turnaround Management Association of Australia (the **TMA**) welcomes the opportunity to provide submissions in response to the consultation paper *Helping Companies Restructure by Improving Schemes of Arrangement* dated 2 August 2021 issued by The Treasury of the Government of the Commonwealth of Australia (the **Consultation Paper**).

The TMA is a community of professionals dedicated to turnaround and corporate renewal, with a diverse membership group consisting of many disciplines committed to stabilising and revitalising corporate value.

TMA members have had leading roles in many if not all of the 19 creditors' schemes of arrangement that to our collective knowledge have been implemented in Australia since 2008. It is this deep practical experience that informs this detailed, considered submission on how creditors' schemes of arrangement could be improved, and other amendments that could potentially be made to Australia's corporate insolvency and restructuring regime to further facilitate successful restructuring.

Consistent with our engagement with Treasury since the onset of COVID-19, the TMA has put significant work and thought into our response. To facilitate an overarching assessment of the use and operation of creditors' schemes of arrangement as a restructuring tool in Australia, the TMA in this submission seeks to explore a wide range of considerations and recommended reforms. It draws on input from our directors and members, as well as developments in relevant off-shore jurisdictions where similar regimes and reforms have been considered and implemented including, in particular, the United Kingdom and Singapore.

The submission:

- responds to the specific questions posed, primarily directed to whether there should be an automatic moratorium in relation to a creditors' scheme of arrangement;

- addresses in detail a suite of potential reforms that the TMA considers would improve the efficiency and effectiveness of creditors' schemes of arrangement overall and which the TMA recommends; and

- discusses other possible reforms including the introduction of a general debtor-in-possession moratorium regime or a priority rescue financing regime. Whilst the TMA considers these potential reforms to be important issues, and worthy of consideration, they involve complex policy and legal issues that need further consideration. Such reforms would also have significantly broader application than just to the creditors' schemes of arrangement procedure (which are used only by a small number of companies). The TMA therefore considers that it would be inappropriate to "bolt on" such regimes to any reforms concerning creditors' schemes of arrangement. Instead, the TMA suggests that these reforms require careful further consideration in a broader context as part of a holistic reform of Australia's restructuring and insolvency laws informed by international experience.

The core TMA team that has worked on the submission are as follows:

- Paul Apathy, TMA Australia Director (Partner, Herbert Smith Freehills)
- Angus Dick (Solicitor, Herbert Smith Freehills)
- Jennifer Ball, TMA Australia Director (Partner, Clayton Utz)
- Alinta Kemeny (Partner, Ashurst)
- Maria O'Brien, TMA Australia President (Partner, Baker McKenzie)

The TMA also warmly thanks Andrew Rich, Natasha McHattan, William Chew, Mitchell Brunker and Stephanie Rowell (all of Herbert Smith Freehills), Grace Lancaster and Lachlan Patey (of Clayton Utz) and Bernice Chen and Alasdair Huggett (of Ashurst) for their significant assistance in considering the matters raised by the Consultation Paper and preparing the TMA's submissions.

Sincerely,

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Helping Companies Restructure by Improving Schemes of Arrangement

TMA Australia Submissions

17 September 2021

Lodged on 17 September 2021 pursuant to extension permitted by The Treasury

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1 Introduction

1.1 Introduction

The Turnaround Management Association of Australia (the **TMA**) welcomes the opportunity to provide submissions in response to the consultation paper *Helping Companies Restructure by Improving Schemes of Arrangement* dated 2 August 2021 (the **Consultation Paper**) issued by The Treasury of the Government of the Commonwealth of Australia (the **Government**).

1.2 About the TMA

The TMA is a community of professionals dedicated to turnaround and corporate renewal, with a diverse membership group consisting of many disciplines committed to stabilising and revitalising corporate value. Accordingly, TMA has a body of members with a deep pool of experience in drafting, negotiating and implementing creditors' schemes of arrangement in Australia.

The TMA subcommittee members (and their related firms) who have prepared these submissions have had substantial involvement in developing the majority of creditors' schemes of arrangement implemented from 2008–2021 (which are summarised in Schedule 1) thus highlighting the depth of experience and knowledge which the TMA can provide to the matters being assessed in the Consultation Paper.

1.3 Outline of submissions

Creditors' schemes of arrangement are the least utilised of the external administration regimes available under Chapter 5 of the *Corporations Act 2001 (Cth)* (**Corporations Act**). However, the utilisation rate alone does not provide a complete picture as to the effectiveness of creditors' schemes of arrangement or the specific role they play in the restructuring landscape.

If the policy objective underlying the Consultation Paper is to increase the use of creditors' schemes of arrangement it is suggested that this should be pursued by assessing a suite of potential reforms to improve the efficiency and effectiveness of creditors' schemes of arrangement overall, rather than simply assessing whether an automatic moratorium should be grafted onto the existing legislative regime.

To facilitate an overarching assessment of the use and operation of creditors' schemes of arrangement as a restructuring tool in Australia, the TMA in this submission seeks to explore a wide range of considerations and recommended reforms as well as provide an overview of the developments in overseas jurisdictions where similar regimes and reforms have been considered and implemented.

Drawing on the collective experience of the TMA members, this document provides the Treasury with comprehensive submissions in respect of the Consultation Paper.

1.4 Acknowledgement

The TMA and the authors of these submissions acknowledge the assistance and feedback of the various TMA members who have contributed to the discussion of the issues surveyed in these submissions, as well as the other local and international

professionals and academics who have kindly shared their time and insights with us. Any errors or omissions are attributable to the relevant authors.

1.5 Views expressed in these submissions

The views expressed in these submissions represent the views of its authors, but do not necessarily reflect the views of all members of the TMA. In preparing these submissions the authors have sought and considered the views of TMA members, and sought to reflect a considered position that on the key questions best reflects the majority views of the broader TMA membership.

However, as can be expected for a "broad church" such as the TMA, contrary views have been expressed to us on a number of the points made herein. We have endeavoured to note the key places where this is the case.

1.6 Intellectual property

The contents of these submissions remain the intellectual property of the relevant authors and/or the TMA as applicable. These submissions may be reproduced but should not be used or reproduced without attribution to the TMA.

1.7 Disclaimer

The contents of these submissions are for reference purposes only and may not be current as at the date of these submissions. The submissions provide a summary only of the subject matter covered, without the assumption of a duty of care by the TMA, its members or any of the contributing authors. The submissions do not constitute legal advice and should not be relied upon as such.

1.8 Glossary

These submissions use a number of abbreviations or defined terms. For ease of reference these are set out here:

2016 Review	means the UK Insolvency Service's Review of the Corporate Insolvency Framework in 2016.
ABL Submissions	means Arnold Bloch Leibler's submissions to the Productivity Commission.[1]
ASIC	means the Australian Securities and Investments Commission.
ASX	means the Australian Securities Exchange.
Automatic Moratorium Period	means the interim thirty day moratorium period provided for in respect of the Singapore scheme moratorium regime.

[1] Arnold Bloch Leibler, Submission No 23 to Productivity Commission, *Business Set-Up, Transfer and Closure* (25 February 2015) <https://www.pc.gov.au/inquiries/completed/business/submissions>.

Blocking Group	means a dissenting financier group representing 25% or more of the class of scheme creditors seeking to: • accelerate debt; • enforce security; • wind up the company; or • sue for due debt, either before or after a scheme is "proposed".
CAMAC	means the Corporations and Markets Advisory Committee.
CAMAC Report	means CAMAC's final report entitled 'Rehabilitating large and complex enterprises in financial difficulties' dated 7 October 2004.
CIGA	means the *Corporate Insolvency and Governance Act 2020* (UK).
Chapter 11	means Chapter 11 of the US Bankruptcy Code.
COMI	means centre of main interests.
Consultation Paper	means the consultation paper *Helping Companies Restructure by Improving Schemes of Arrangement* dated 2 August 2021 issued by The Treasury of the Government of the Commonwealth of Australia.
Corporations Act	means the *Corporations Act 2001* (Cth).
Corporations Regulations	means the *Corporations Regulations 2001* (Cth).
CVA	means the UK company voluntary arrangement process.
DOCA	means deed of company arrangement.
EU Restructuring Directive	means Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and

	discharge of debt, and amending Directive (EU) 2017/1132 [2019] OJ L 172/18.
GFC	means the 2008 Global Financial Crisis.
Government	means the Government of the Commonwealth of Australia.
Harmer Report	means the Law Reform Commission's report entitled 'General Insolvency Inquiry' dated 13 December 1988.
ILRC	means the Insolvency Law Reform Committee (Singapore).
IRDA	means the *Insolvency, Restructuring and Dissolution Act 2018* (Singapore).
Minority Group	means a dissenting financier group representing less than 25% of the class of scheme creditor seeking to: • accelerate debt; or • enforce security, after the scheme is "proposed".
Moratoria Guidance	means the *Guide for the Conduct of Applications for Moratoria under Sections 64 and 65 of the Insolvency, Restructuring and Dissolution Act 2018* (Singapore).
Part A1 Moratorium	means the moratorium rescue process provided for under Part A1 of the UK Insolvency Act.
PC Report	means the Productivity Commission's 2015 report on "Business set-up, transfer and closure".
Practice Statement	means the practice statement issued by the Chancellor of the High Court of England and Wales titled "Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)".
Practice Statement Letter	means the letter sent by the company to scheme creditors ahead of the first court hearing pursuant to the Practice Statement.

Re Boart	means *Re Boart Longyear Ltd* [2017] NSWSC 537.
Re Glencore	means *Re Glencore Nickel Pty Ltd* [2003] WASC 18.
Singapore Amending Act	means the *Companies (Amendment) Act 2017* (Singapore).
Singapore Government	means the Government of Singapore.
TMA	means the Turnaround Management Association of Australia.
UK	means the United Kingdom.
UK Companies Act	means the *Companies Act 2006* (UK).
UK Government	means the Government of the United Kingdom.
UK Insolvency Act	means the *Insolvency Act 1986* (UK).
UNCITRAL Model Law	means the United National Commission on International Trade Law Model Law on Cross-Border Insolvency adopted 30 May 1997.
United States	means the United States of America.
US Bankruptcy Code	means Title 11 of the United States Code.

2 TMA approach to Consultation Paper

2.1 Approach to insolvency and restructuring law reform

In preparing this response to the Consultation Paper the TMA has chosen to take a holistic approach to the consideration of law reforms to improve the operation, effectiveness and utilisation of creditors' schemes of arrangement in respect of corporate restructuring. We have highlighted how creditors' schemes of arrangement are actually used in practice, considered the operation of the existing law within that context, considered the broader Australian insolvency and restructuring law framework, and drawn upon the experience of other jurisdictions which have similar scheme of arrangement laws and have previously undertaken reforms similar to those suggested in the Consultation Paper.

The comprehensive nature of this response highlights the complexity and interrelated nature of proposed law reform projects which are aimed at improving Australia's restructuring and turnaround culture and legal framework. As noted in this response many of the proposed amendments identified in the Consultation Paper, while appearing simple, involve challenging issues which require careful analysis. Without a clear understanding of how Australian restructuring and insolvency law works in practice, any reforms to creditors' schemes of arrangement in Australia are unlikely to achieve the desired objective and may result in unintended consequences.

The TMA considers that there are significant advantages to the Government undertaking a holistic and thorough review of Australia's restructuring and insolvency framework by one or more appropriate experts (which has not occurred since 1988).[2] A review of this sort is long overdue, and is something that should be prioritised over further piecemeal reform.

2.2 Creditors' schemes of arrangement

The TMA makes the following observations in respect of creditors' schemes of arrangement:

- The main use of creditors' schemes of arrangement in Australia is as a mechanism to implement the restructuring of financial debt in large companies, usually as the final stage of a private "out-of-court" restructuring negotiation between a company and its financial creditors.
- While there are areas for suggested improvement, the use of Australia's existing creditors' scheme of arrangement is generally considered to offer a familiar, predictable and fair regime which facilitates restructurings and turnarounds in a non-disruptive, and therefore value preserving, manner. The regime plays an important role in our insolvency and restructuring framework.
- The experience of other jurisdictions, particularly the United Kingdom (**UK**) and Singapore, which have recently undertaken reforms relating to their creditors' scheme of arrangement regimes, provides useful case studies from which learnings can be drawn.
- The TMA does not consider that the inclusion of an automatic moratorium into the creditors' scheme of arrangement regime would improve the operation or

[2] Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 13 December 1988) (the **Harmer Report**).

use of this process, rather its inclusion could create significant issues and complexities and ultimately result in unintended consequences.

- The TMA does consider that a number of other changes can be made to Australia's creditors' schemes of arrangement regime which would be beneficial. We discuss the TMA's recommendations in respect of law reform in this area further at section 2.3 below.

2.3 TMA's recommended approach

The TMA recommends that Government take the following approach with respect to law reform in this area:

(a) Proceed with caution

Corporate restructuring is a complex area, involving an intersection of many rights, issues and stakeholders. Law reform in this space is not straightforward, and recent experience, both in Australia and internationally, demonstrates that rushed amendments frequently fail to achieve their aims.

The Government should therefore proceed with caution, particularly where there is not a clear legislative regime already in existence and operating successfully in another comparable jurisdiction upon which we can draw.

(b) Prioritise clear and beneficial reforms

With respect to creditors' schemes of arrangement, the TMA nevertheless considers that there are a number of beneficial reforms that can be made relatively quickly.

These are reforms where both of the following are reasonably clear:

- the legislative approach (because for example, there is well-drafted legislation from a foreign jurisdiction that can be easily incorporated into the existing Australian legislation, or the legislative change is relatively simple); and
- the effect and benefits of the reform.

(c) The reforms to undertake now

In the TMA's view, the reforms that meet the criteria set out in section 2.3(b) above, and that should be undertaken now, are:

- **cross-class cram downs**: introduce a cross-class cram down mechanic (based on the UK Part 26A "restructuring plan");[3]
- **section 411(16)**: make some adjustments and clarifications to the manner and extent that stay orders may be made by the Court under section 411(16) of the Corporations Act;[4]
- **practice statement**: introduce a "practice statement" regime, similar to that applicable in the UK, that would ensure proper notice to creditors, and ventilation of the key jurisdictional and class issues, at the first creditors' scheme meeting;[5]

[3] See section 7 below. See section 5.4(g) below for a discussion of the UK "restructuring plan".

[4] See section 6.13 below.

[5] See section 8.2below.

- **streamline ASIC review**: shorten the Australian Securities and Investments Commission (**ASIC**) review process to one week (and allow ASIC to benefit from the practice statement reforms);[6]
- **foreign companies**: allow foreign companies with a "sufficient connection" to Australia to undertake creditors' schemes of arrangement in Australia (in line with the approach in other jurisdictions);[7]
- **public disclosure**: require the public disclosure of creditors' scheme of arrangement documents and orders through lodgement with ASIC as a matter of transparency, consistency, good market practice and equality of access to information;[8]
- **remove headcount test**: remove the "headcount" test for voting on creditors' schemes of arrangement (so voting is just based on value of claims, but not the number of creditors), to reduce the uncertainty and to prevent "vote-splitting" from distorting voting outcomes (but retain the 75% voting threshold by value);[9]
- **pre-packaged schemes**: consider introducing "pre-packaged" schemes of arrangement (similar to the Singapore model) to allow quicker, cheaper and more efficient scheme processes in appropriate cases;[10] and
- **binding class orders**: introduce the ability for the Court to make binding class order determinations at the first court hearing.[11]

(d) Debtor-in-possession moratoriums and rescue financing require deeper review

Other reforms, including a general debtor-in-possession moratorium[12] or a priority rescue financing regime,[13] involve complex issues, and are matters that we consider are more difficult to introduce and get right. The benefits of such reforms remain unclear. In our view, there is no clear international 'best model' for Australia to follow in respect of these reforms.

Furthermore, neither of these matters have a clear nexus to creditors' schemes of arrangement — in truth they are general restructuring issues, and it makes little sense to address them only in the context of creditors' schemes of arrangement.

Accordingly, the TMA considers that these reforms require further consideration and should be explored as part of a holistic reform of Australia's restructuring and insolvency laws. The TMA does not consider that it would be appropriate to bolt on such reforms to any reforms concerning creditors' schemes of arrangement.

(e) Holistic review of Australia's restructuring and insolvency laws is needed

The TMA considers that it is time to undertake a holistic review of restructuring and insolvency laws in Australia, including the possibility of reforms to incorporate debtor-in-possession moratoriums or priority rescue financing.

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6 See section 8.3 below.

7 See section 8.5 below.

8 See section 8.6 below.

9 See section 8.7 below.

10 See section 8.8 below.

11 See section 8.9 below.

12 See section 6.11 below.

13 See section 8.4 below.

Such a review should draw on both the international experience and a full and comprehensive examination of what is, and what is not, working with Australia's existing laws. This review should set the agenda for further Government review in this space.

3 Responses to Treasury's questions

Question	TMA Response
1. Should an automatic moratorium apply from the time that a Company proposes a scheme of arrangement? Should the automatic moratorium apply to debt incurred by the Company in the automatic moratorium period?	***We do not think that an automatic moratorium should apply from the time that a company proposes a scheme of arrangement.***[14] We do not think there is any need for any automatic moratorium from the time that a company proposes a scheme of arrangement given the: • fact that creditors' schemes of arrangements are generally used at the final stage of private "out-of-court" restructurings in respect of financial creditors only; • general prevalence of contractual or de facto standstills and subordination regimes under the relevant finance documents where creditors' schemes are proposed; • existing section 411(16), which allows a court to stay actions (including winding up petitions) against the company, has been only very rarely utilised in creditors' schemes of arrangement to date;[15] and • practical usage of creditors' schemes of arrangement in Australia evidences no need for a moratorium. To the extent a company requires a broader stay in respect of trade creditors (eg because it is unable to pays its debts), a company may avail itself of the existing voluntary administration regime which contains a broad statutory moratorium. A creditors' scheme of arrangement may be proposed while a company is in voluntary administration. Furthermore, there is a risk that an automatic moratorium could be counterproductive to a company's restructuring efforts in that it could alarm trade creditors or other counterparties, and result in a withdrawal of credit or other dealings with the company and disrupt day to day operations. The use of creditors' schemes (and the out-of-court restructurings in respect of which they form a part) are generally undertaken to avoid these disruptions. The introduction of a broad and automatic moratorium is likely to raise a significant number of issues, particularly if the moratorium is intended to apply for any significant period of time. The practical effect of introducing such a moratorium could in practice amount to creating a new debtor in possession insolvency regime.

[14] We note that the TMA working group did receive a contrary view from one TMA member on this point. The contrary view was that emphasis should be put on saving the company, even if it risked some detriment to individual creditors. We discuss these issues at section 6.5 below.

[15] See Schedule 1.

Question	TMA Response
	The introduction of such a regime is therefore not a matter of minor drafting or the inclusion of a "voluntary administration" style moratorium into the creditors' scheme of arrangement regime. Any such amendment to the existing section 411(16) of the Corporations Act or introduction of a separate automatic stay, if adopted, will need to ensure: clarity as to its purpose, scope and period of operation; include appropriate oversight of the company's operations and actions during the stay period; provide for transparency and appropriate disclosure to creditors; provide protection for creditors supplying to the company in the moratorium period; and integration with the broader Australian insolvency framework. We query the merit of introducing an automatic moratorium, giving rise to many complex issues, in respect of creditors' schemes of arrangement given they are used comparatively rarely in Australia (and given their existing usage evidences no need for such a moratorium), but where they are used are working well. See the more detailed discussion on the above issues in sections 6.3–6.11.
2. Would the moratorium applied during voluntary administration be a suitable model on which to base an automatic moratorium applied during a scheme of arrangement? Are any adjustments to this regime required to account for the scheme context? Should the Court be granted the power to modify or vary the automatic stay?	***For the reasons set out above, we do not think that an automatic moratorium would be appropriate in connection with a scheme of arrangement. Further, we do not consider that the broad statutory moratorium applying under a voluntary administration should be applied to a scheme of arrangement.*** In particular, we think that the voluntary administration moratorium, which is very broad, would be inappropriate in most cases where parties seek to use creditors' schemes of arrangement to undertake a private, out-of-court restructuring, given how disruptive this would be to the company's counterparties, creditors and employees. Should a company's liquidity position be so severe that it requires a broad moratorium in respect of all of its creditors then the most appropriate option is for the company enter into voluntary administration to access the benefit of that moratorium. It is noted that a company in voluntary administration can undertake a creditors' scheme of arrangement if that is determined to be the most appropriate course (as demonstrated by the Quintis case). However, in the vast majority of cases where voluntary administration is used, a deed of company arrangement (**DOCA**) is a more efficient method of restructuring companies in administration (indeed this was the original reason that the DOCA process was proposed in the Harmer Report, and this has been borne out by current practice). If a broad voluntary administration style moratorium is introduced as part of a scheme of arrangement process, the need will arise to enact a significant number of additional provisions in order to make such a broad moratorium practically operable in the context of the scheme of arrangement regime. As noted above, the grafting of a broad automatic moratorium into the creditors' scheme of arrangement is likely to have the practical

Question	TMA Response
	effect of creating of a de facto debtor in possession insolvency regime. If this is to occur, such a regime will need to ensure: • clarity as to its purpose, scope and period of operation; • appropriate oversight of the company's operations and actions during the stay (for example through a monitor); • transparency and appropriate disclosure to creditors, and disclosure of the company's status as subject to a moratorium; • a regime for priority payment of (appropriate) debts incurred during the moratorium (given counterparties will likely be unwilling to extend any credit without such a regime); • integration with the broader Australian insolvency framework, including determination of issues such as whether transactions during the stay period will be subject to the voidable transaction regime or provable debts in a subsequent liquidation, the application of the ipso facto provisions and the interface with the safe harbour; and • the court's powers generally in respect of all of these matters, and including the power to modify or vary the stay. There may be merit in considering a standalone debtor in possession regime (that could be combined with a scheme of arrangement, DOCA or sale as possible "exit" routes), perhaps in a similar vein to the Part A1 Moratorium introduced in the new Part A1 of the *Insolvency Act 1986* (UK) (**UK Insolvency Act**) (**Part A1 Moratorium**) . However we think this requires further and more detailed consideration to determine whether such a regime is worthwhile or appropriate in Australia, and what adjustments would be needed for it to operate properly. See the more detailed discussion on the above issues in sections 6.3–6.11.
3. When should the automatic moratorium commence and terminate? Are complementary measures (for example, further requirements to notify creditors) necessary to support its commencement?	***For the reasons set out above, we do not think that an automatic moratorium would be appropriate in respect of a scheme of arrangement.*** ***However, where a moratorium is considered it is important to consider two periods:*** • **the negotiating period**: the period prior to the formal proposal of the scheme, where the company and its creditors are developing and negotiating a restructuring; and • **the implementation period**: the period following the formal proposal of the scheme until it takes effect, being the period in which the court application is made, the first court hearing, the meeting of scheme creditors and the second court hearing, occur. In respect of the **negotiating period**, there are potential difficulties with introducing a stay particularly given there is no obvious "start point". In practice the negotiating period typically involves consensual discussions encompassing a range of parties, matters and options that develop over time. Furthermore, there is no certainty during the negotiating period that any scheme of

Question	TMA Response
	arrangement will ever be proposed. In practice a company may be considering a number of options in parallel during this period (such as a capital raise, a sale, a fully consensual restructuring, a scheme or voluntary administration). It is unclear why a moratorium should attach to only one of these possible options. In respect of the **implementation period**, we note that the existing section 411(16) stay is already available which largely addresses the issues that can arise during this period. We have suggested some modest amendments that could be made to section 411(16) (at section 6.13) to further enhance its operation in that regard. ***Accordingly, if a moratorium is to be introduced it would be more sensible to introduce it as a standalone procedure, giving the company the option of a short period of "breathing room" to consider its options and engage with its creditors. The company could then exit from such a standalone moratorium through the most appropriate pathway which could include a scheme of arrangement, an administration and/or DOCA, a sale process or some other transaction***. Any moratorium should be required to be publicly registered with ASIC, and the company should be required to disclose its status as being subject to a moratorium on its public documents in a similar manner to a company that is subject to administration, receivership or liquidation. See the more detailed discussion on the above issues in section 6.11.
4. How long should the automatic moratorium last? Should its continued application be reviewed by the Court at each hearing?	***For the reasons set out above, we do not think that an automatic moratorium would be appropriate in respect of a scheme of arrangement.*** ***However, if it is determined that an automatic moratorium is to be introduced, then it should be subject to a fixed time limit. Otherwise there is a risk that such a moratorium would be open ended, noting that there is no fixed statutory timetable within which a scheme of arrangement needs to be concluded, and its continued application should be subject to court review.*** If the scheme was to be withdrawn or fail then any automatic moratorium would need to end immediately, and assessment should be made of whether the company should transition automatically to administration (or liquidation). See the more detailed discussion on the above issues in sections 6.3–6.11.
5. Are additional protections against liability for insolvent trading required to support any automatic moratorium?	***For the reasons set out above, we do not think that an automatic moratorium would be appropriate in respect of a scheme of arrangement.*** ***However, if it is determined that an automatic moratorium is to be introduced, we consider that consideration should be given to whether it is appropriate for the insolvent trading regime to***

Question	TMA Response
	apply at all during the period of an automatic moratorium — this will depend ultimately on the public disclosure of the moratorium, the nature of the regime and the controls and restrictions placed on the company. As a matter of principle, if there is a broad "all encompassing" moratorium in place in respect of creditor claims this will need to be publicly disclosed, such tat counterparties are aware of the risk before entering into new arrangements with the company, and therefore the same creditor protection policy applying prior to a company's entry into a formal insolvency process seems less important. Further, as a matter of practice the introduction of a moratorium would necessitate the inclusion of a priority regime to apply in respect of any further debt being incurred by the company during this process otherwise few creditors will be willing to advance credit during this period. If these features are in place, together with suitable oversight of the company and restrictions on transactions outside the ordinary course of business, then the insolvent trading regime does not seem necessary or appropriate (ie the position of the company in moratorium should be considered akin to the position of the company in voluntary administration). Alternatively, if a more limited moratorium, for example a specific stay order under section 411(16) of the Corporations Act in respect of a limited group of creditors, then we consider that the existing insolvent trading safe harbour protection (section 588GA of the Corporations Act) provides a reasonable basis to protect directors from insolvent trading risk during the period of negotiation and proposal of a scheme of arrangement. There are some improvements and clarifications that could be made to the insolvent trading safe harbour which we expect will be addressed as part of the safe harbour review panel's work. See the more detailed discussion on the above issues in sections 6.3–6.11.
6. What, if any, additional safeguards should be introduced to protect creditors who extend credit to the Company during the automatic moratorium period?	***For the reasons set out above, we do not think that an automatic moratorium would be appropriate in respect of a scheme of arrangement.*** ***However, if an automatic moratorium was introduced a significant number of safeguards should be considered to protect creditors who extend credit to the company during the automatic moratorium period.*** The potential safeguards which should be considered include requirements for: • creditors to be notified that the company was subject to the automatic moratorium before they extend credit to the company; • heightened public disclosure as to the company's financial position (the form, frequency and content of such disclosure would need careful consideration);

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	• a clear priority regime applying to any liabilities incurred during the moratorium period in respect of any subsequent liquidation of the company; • clarity as to whether payments or other transactions made by the company during the moratorium period could be subject to the voidable transaction regime in any subsequent liquidation of the company; • clarity as to the length of the moratorium, and whether the debts will be paid during or after the moratorium; • restrictions on payments, disposals or grants of security by the company outside the ordinary course of business; and / or • a form of oversight of the company, whether by the Court, a "monitor" or some other appropriate mechanism. We note that these protections would be important for pre-existing creditors of the company as well as those who extend credit during the moratorium period. Detailed discussion on the above issues is included in sections 6.5–6.7.
7. Should the insolvency practitioners assisting the Company with the scheme of arrangement be permitted to act as the Voluntary Administrators of the Company on scheme failure?	***We do not consider that assisting a company with preparation of a scheme of arrangement is materially different from undertaking other restructuring activities prior to appointment as voluntary administrator, and therefore we consider that the same independence principles should generally apply.*** If a form of automatic moratorium is introduced, and noting our recommendation that there be a monitor type role, this could potentially be undertaken by an insolvency practitioner. In such circumstances the usual independence principles should apply in assessing whether an insolvency practitioner who has acted as a monitor should be able to go on to a subsequent formal appointment and what protections may be appropriate to ensure independence. Detailed discussion on the above issue is included in section 6.5.
8. Is the current threshold for creditor approval of a scheme appropriate? If not, what would be an appropriate threshold?	***We consider that the 75% by value threshold for creditors' schemes of arrangement is appropriate.*** Given: • the significant changes that can be made to counterparties' rights under a scheme; and • the fact that such alteration of rights can occur outside a formal insolvency process, it is important that a high degree of creditor support be provided for a creditors' scheme of arrangement to become effective. There is no practical evidence to suggest that the 75% approval threshold has caused any problems in practice. We also note that the 75% threshold is common to all creditors' schemes of

Question	TMA Response
	arrangement regimes across other jurisdictions (including the UK and Singapore which are discussed in this submission). ***However, while we support the maintenance of the 75% approval threshold, we consider there is considerable merit in abolishing the requirement for a majority in number of creditors to approve the scheme (the "headcount test"). We note that after a public consultation process, the Corporations and Markets Advisory Committee (CAMAC) also recommended the abolition of the headcount test, albeit in the context of members' schemes.*** The headcount test introduces a degree of uncertainty into the scheme process due to the potential for creditors to "split" their votes by transferring parts of their holding to multiple other entities. As an alternative to this we believe that the court should be given the discretionary power to disregard the headcount test in the same way that it can in the case of a members' scheme of arrangement. Given that creditors' schemes of arrangement have the twin protections of: • a class voting regime; and • the ability of the court to discount or disregard votes on the grounds of extraneous interests, together with the fact that they are generally only used for compromising financing debts, we think there is no need to have a test aimed to protect large numbers of small holders. A more detailed discussion on the above issues is detailed in section 8.7.
9. Should rescue, or 'debtor-in-possession', finance be considered in the Australian creditors' scheme context?	***There has, for some time been discussion of the potential for reforms to Australia's restructuring and turnaround frameworks to facilitate financing regimes for distressed companies and the TMA considers the availability of financing for distressed companies to be an important factor in the successful restructuring and turnaround outcomes.*** ***However, we are not convinced that introduction of a "rescue" or "debtor in possession" financing regime similar to that in the United States of America (the United States) or Singapore in connection with creditors' schemes of arrangement would meaningfully improve access to such funding in those cases.***[16] It is not clear that the introduction of a rescue / DIP financing regime (similar to that in the United States or Singapore) will make a significant difference to the availability of finance to most companies looking to restructure through a creditors' scheme of arrangement. This is because most such companies will have already granted security over all of their assets to their existing lenders, and the existing debt is likely to exceed the value of that

16 We note that the TMA working group did receive a contrary view from one TMA member on this point who considered that rescue financing should be made available without the requirement for adequate protection for existing secured creditors. We discuss these issues at section 8.4 below.

Question	TMA Response
	security. Even under the United States and Singapore rescue / DIP financing regimes it would not be possible to "prime" these existing secured lenders without their consent in such circumstances. Accordingly, even in the United States (where the rescue / DIP financing market is most advanced), most rescue/DIP finance is advanced on a consensual basis by the existing financiers. This already occurs in Australia, given where a restructuring will generate a better return for existing lenders (including secondary distressed debt investors) they will generally be incentivised to advance such financing. Furthermore, we note that similar timing issues arise in respect of any rescue / DIP financing regime associated with creditors' schemes of arrangement as discussed in respect of an automatic moratorium regime (see discussion in respect of question 3 above). Where a company need rescue / DIP financing it is likely that such need will arise in the earlier negotiating period, before there is any clear scheme of arrangement being proposed. It is also unclear why a rescue / DIP financing regime should be limited to creditors' schemes of arrangement, given the small number of creditors' schemes of arrangement in the Australian market. Therefore, whilst we consider this a topic worthy of further consideration, we do not recommend introducing a specific rescue / DIP financing regime for creditors' schemes of arrangement. See sections 5.3(d), 5.3(e) and 8.4.
10. What other issues should be considered to improve creditors' schemes?	***A consideration of potential reforms to improve the effectiveness and uptake of schemes of arrangement should be made in the context of additional reforms which have the potential to significantly improve their operation.*** ***We recommend the following additional reforms should be made to improve the operation and effectiveness of creditors' schemes of arrangement in Australia:*** • introduce a ***cross-class cram down*** in respect of both creditors and shareholders based on the UK's new "restructuring plan" contained in Part 26A of the *Companies Act 2006* (UK) (**Companies Act**) (see sections 5.4(g), 7.6);[17] • introduce a ***practice statement*** regime, similar to that applying to schemes and restructuring plans in the UK, to ensure (among other things) that scheme creditors are appropriately notified of the key issues to be addressed at the first scheme hearing by way of a ***practice statement letter***. This will allow scheme creditors to meaningfully participate in that court hearing and help ensure that class composition and jurisdictional issues are appropriately addressed at that hearing (see section 8.2); • ***streamline the ASIC review process*** to shorten the ASIC review process (which does not occur in other jurisdictions) and to provide ASIC with a copy of the practice statement letter

[17] We note that the TMA working group did receive a contrary view from one TMA member on this point. The contrary view was that cross-class cram downs mainly benefit foreign funds rather than Australian companies or banks. We address this point at section 7.8 below.

Question	TMA Response
	(referred to above) to facilitate greater efficiencies in ASIC's role (see section 8.3); • ***extend the scope of jurisdiction*** to propose a scheme of arrangement to ***include foreign companies with sufficient connection to Australia*** to allow greater flexibility and in accordance with modern restructuring practice in other countries (see section 8.5); • introduce a ***requirement to lodge scheme explanatory statements and related documents and orders*** with ASIC for public disclosure to promote greater transparency and equality of access to information (see section 8.6); • consider adopting a streamlined ***"pre-packaged" schemes regime***, dispensing with the need for the meeting of creditors and the first court hearing where the requisite creditors have already agreed to support the scheme, similar to the concept recently introduced in Singapore (see section 8.8); and • provide the Court with additional powers to make ***binding determinations on class composition at the first court hearing*** and ***curative powers in the event that classes have been incorrectly marshalled*** (see section 8.9).
11. Are there any other potential impacts that should be considered, for example on particular parties or programs? If so, are additional safeguards required in response to those impacts?	***See recommendations and related discussions as set out above.***

4 Operation of creditors' schemes of arrangement in Australia

4.1 Overview

As background for our observations and recommendations in sections 5 to 8 of these submissions, we set out in this section 4 an overview of how creditors' schemes of arrangement tend to be utilised in practice in Australia, and in particular how they operate in respect of restructurings.

In particular we:

- provide a brief overview of creditors' schemes of arrangement in section 4.2;
- survey the creditors' schemes of arrangement that have actually occurred in Australia since 2008 in section 4.3;
- explain how creditors' schemes of arrangement are used as part of a broader "out-of-court" restructuring process in sections 4.4 and 4.5;
- explain that the increased amount of debt, and the development of the secondary debt market, in the Australian market have been key factors in the rise of out-of-court restructuring processes using creditors' schemes of arrangement in section 4.6;
- discuss the stay orders that may be made by the court under existing section 411(16) of the Corporations Act in connection with creditors' schemes of arrangement (and the fact these are rarely used in practice) in section 4.7;
- provide a brief comparison of creditors' schemes of arrangements and DOCAs at section 4.8;
- consider why there are a fairly small number of creditors' schemes of arrangement undertaken in Australia, and whether this represents significant untapped demand for creditors' schemes of arrangement, in section 4.9; and
- discuss the impact of the introduction of the safe harbour regime in Australia in section 4.10.

4.2 An overview of creditors' schemes of arrangement

(a) What is a creditors' scheme of arrangement?

A creditors' scheme of arrangement is a statutory procedure involving a compromise or arrangement between the scheme company and certain of its creditors, which modifies the existing rights of the relevant creditors against the scheme company.

To vote on whether to agree to the arrangement or compromise, the creditors with whom or with which the company seeks to reach a compromise are marshalled into classes based on their rights (not their interests) for the purpose of voting on and agreeing to the scheme proposed by the company.

Whilst a creditors' scheme of arrangement can operate upon all of the scheme company's creditors, it is more common for the scheme to form a compromise or arrangement only with specified groups of creditors. In this regard, the scheme company is free to choose with which creditors it will propose to enter a scheme of arrangement.

The scheme company may either be solvent or effectively insolvent.[18] A creditors' scheme of arrangement can also be used to effect releases of the rights of the relevant creditors against third parties.

The Australian creditors' scheme of arrangement regime is, like the members' scheme of arrangement regime, contained in Part 5.1 of the Corporations Act.

(b) What is the process to implement a scheme of arrangement?

A creditors' scheme of arrangement can take 3 to 4 months to implement, although the timeframe may be shorter or longer depending on how long it takes to negotiate the scheme terms (and any restructuring support agreement, where applicable) with the key supporting creditors.[19] It is important to note that there is no statutory timetable for schemes of arrangement, although they are normally pursued expeditiously because of commercial imperatives.

The following table summarises, at a high-level, the key formal steps to implement a creditors' scheme of arrangement — these are largely the steps set out or anticipated under the statutory provisions including section 411 of the Corporations Act.

The timings in the table are very much indicative and can vary depending on, among other things, the complexity of the scheme and the urgency of the situation.

No.	Step	Indicative timing
1.	**Preparation and negotiation**: Prepare key documents (including the scheme terms, explanatory statement and independent expert's report).	Typically 6–8 weeks (but may be longer or shorter depending on the complexity of the restructuring).
2.	**ASIC review**: Lodge draft explanatory statement with ASIC. ASIC requires a reasonable opportunity to consider the terms of the scheme (including the explanatory statement) and make submissions to the court.	14 day review period.
3.	**First court hearing**: Apply for a court order to convene a meeting of a class or classes of creditors to vote on the scheme and to dispatch the explanatory statement to creditors.	Notice and explanatory statement normally dispatched to creditors on the day, or the day after, the first court hearing (assuming electronic dispatch).
4.	**Notification of creditors**: The applicable class or classes of creditors are notified of the scheme meetings, and sent the explanatory statement in respect of the scheme.	21–28 day notice period for creditors ahead of the meeting of creditors.

[18] Indeed, the original use of schemes of arrangement was to facilitate arrangements within corporate liquidation. This usage has expanded over the years and it is now more common for schemes of arrangement to be used outside of any formal insolvency process.

[19] There is necessarily a lead up period before the formal process summarised in this section and the table below where the commercial terms of the scheme are devised, worked up and generally negotiated with a core group of creditors who would be expected to form a significant proportion of the creditors subject to the terms of the scheme of arrangement. In the case of restructurings, the key commercial terms are often agreed between the core financial creditors supporting the restructuring and the company before the scheme documents themselves are prepared. We discuss this further in section 4.5 below.

No.	Step	Indicative timing
5.	**Meeting of creditors**: Creditors (or classes thereof) vote on the scheme. The scheme must be approved (on a class-by-class basis) by a majority in number of the creditors who vote and who hold at least 75% by value of debts.	Typically 3 day gap between creditors' meeting and final court hearing.
6.	**Final court hearing**: Court considers whether to approve the scheme.	Final court hearing and scheme effective date often occur on the same day.
7.	**Scheme takes effect**: Court orders are lodged with ASIC and the scheme becomes effective.	Typically 0–7 day gap between scheme effective date and implementation.
8.	**Scheme is implemented**: Restructuring steps under the scheme occur in accordance with their terms.	

4.3 Use of creditors' schemes of arrangement in Australia since 2008

As a starting point to consideration of any reforms to creditors' schemes of arrangement in Australia, the TMA believes it is important to have a clear understanding of how creditors' schemes of arrangement are currently used in Australia.

We have prepared a summary of all of the creditors' schemes of arrangement, that we are aware of, that have been undertaken in the Australian market since 2008. This summary is set out at Schedule 1.

We note that ASIC does not maintain a comprehensive public database of all creditors' schemes of arrangement,[20] and therefore this list has been prepared based on the knowledge of the TMA members preparing these submissions[21] and information that has been publicly announced or reported. It is therefore possible there are additional creditors' schemes of arrangement which may have occurred during this time period but have not been included in the list. Noting this, we believe the list at Schedule 1 provides a comprehensive overview.

Our summary indicates that 19 creditors' schemes of arrangement have been implemented in Australia between 2008 to 2021. This is not a particularly large number, equating to, on average, approximately 1.46 creditors' schemes of arrangement per year.

It becomes particularly apparent that creditors' schemes of arrangement are used in only an extremely small subset of situations of corporate distress when these numbers are

[20] We note that ASIC produces a table of companies entering into external administration (Table 1.3) which lists 26 scheme administrators being appointed between 2000 and 2021. However this data is difficult to interpret as it provides no details as to the relevant companies or the nature of the scheme. It also appears that the data may suggest much higher numbers of schemes than actually occur as it appears that where a related group of companies undertake a scheme of arrangement it records an appointment of scheme administrators for each group company undertaking a scheme.

[21] TMA members (and their respective firms) have had substantial roles in most (if not all) of the schemes in Schedule 1.

compared to the numbers of voluntary administrations, deeds of company arrangement or liquidations during the same time period.[22]

Our summary reveals that since 2008, creditors' schemes of arrangement have been used in Australia for the following purposes:

- **liquidation schemes** (4 schemes or 21.05%): these were creditors' schemes of arrangement undertaken where the company was already in liquidation. The purpose of these schemes was to assist the liquidators of insolvent companies to effect a distribution of the company's assets to creditors in a more efficient manner than through liquidation processes alone;
- **restructuring schemes** (15 schemes or 78.95%): these were creditors' schemes of arrangement (mainly) undertaken outside of any formal insolvency process[23] for the purpose of implementing a restructuring and to avoid the need for the company to enter into a formal insolvency process. These can be further sub-categorised as follows:
    - **deleveraging schemes** (10 schemes, or 52.63%%): these were creditors' schemes of arrangement primarily intended to extinguish some or all of a company's finance debts, in order to "right size" the company's balance sheet to a sustainable level. These schemes often involved some form of "debt for equity swap"; and
    - **rescheduling schemes** (5 schemes or 26.32%%): these were creditors' schemes of arrangement primarily intended to effect an extension or rescheduling of a company's finance debts beyond their existing maturities, in order to seek to repay those debts over a longer, more manageable, time period.[24]

The data also suggests that creditors' schemes of arrangement have only been used in situations where there were very large amounts of debt subject to the schemes. The amounts of debt restructured through such schemes of arrangement range from $107.6 million to approximately $3.44 billion,[25] with the median amount of debts subject to a creditors' scheme of arrangement being $740 million. It is clear therefore that creditors' schemes of arrangement are currently only being used in Australia for large corporates with significant amounts of debt.

The majority of the creditors' schemes of arrangement currently undertaken are for the purpose of implementing a corporate debt restructuring outside of formal insolvency processes. Generally this is as part of a "deleveraging" restructuring involving the extinguishment of significant amounts of the company's debt, often in exchange for the creditors receiving equity in the restructured company.

The debt being restructured in this way is almost always finance debt, generally owed under syndicated loan facilities, notes or bonds. Over the 2008 to 2021 period there was

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22 The ASIC Insolvency Statistics note that there were 18,457 voluntary administrators appointed and 6,380 receivers & managers appointed.

23 Note that the creditors' scheme of arrangement in respect of Quintis is an exception as this restructuring combined a creditors' scheme of arrangement with a DOCA and was undertaken while the company was in administration: see item 12 of Schedule 1.

24 We note that the Wollongong creditors' scheme of arrangement gave creditors the option of participating in one of two facilities: Facility A which involved a compromise of principal amounts of up to 29% if the company achieved certain milestones, or Facility B which involved a maturity date extension but no compromise of principal amounts. For these purposes we have classified this as a rescheduling of debt as the debt reduction was optional: see item 16 in Schedule 1.

25 In the 2018 Wiggins Island Coal Export Terminal Pty Ltd creditors' scheme of arrangement, the amount of scheme debts was US$3 billion, which is approximately A$4.11 billion as at the effective date of the scheme (21 September 2018): see item 14 of Schedule 1.

only one restructuring undertaken by way of scheme of arrangement involving a compromise of the claims of trade creditors, employees or other non-finance creditors (being the scheme process implemented for Ovato Print Ltd).[26] Such non-finance creditors are generally left outside of the creditors' scheme of arrangement and continue to be dealt with in the ordinary course of business. In other words, the rights of non-finance creditors are generally not compromised in connection with a creditors' scheme of arrangement.

We will touch further on the reasons for this pattern of usage of creditors' schemes of arrangement in the Australian market in some of the following sections.

4.4 The role of creditors' schemes of arrangement in restructurings

(a) The main use of creditors' schemes of arrangement

Given that the main use of creditors' schemes of arrangement is to implement restructurings of financially distressed companies, generally through some combination of a reduction or rescheduling of one or more classes of finance debt of the company, it is therefore also important to understand the role and purpose of the creditors' scheme of arrangement in this broader restructuring context.

Creditors' schemes of arrangement are generally used as a means of implementing a broadly consensual restructuring agreed between a company and a class of its financial creditors. These restructuring processes are almost always what are termed "out-of-court" processes.

(b) Out-of-court restructurings[27]

An out-of-court restructuring is a restructuring undertaken outside of any formal insolvency proceedings being commenced in respect of the company.

During this process the company will (generally) continue to operate on a normal going concern basis (albeit under some degree of financial pressure) and trade creditors and counterparties will (generally) continue to be paid in the normal manner (although sometimes with a degree of "stretching").

Directors and management will remain in control of the company during this period.

These restructuring negotiations generally occur where the key problem that the company is facing is over leverage — (ie it is unable to service or repay its financial debt as stipulated under its finance contracts). However, the restructuring discussions proceed on the premise that there is nonetheless a viable underlying business that can be rescued by some degree of reduction or rescheduling of the company's debts, often combined with an operational turnaround of underperforming elements of the business and an injection of additional capital to fund the turnaround.

Such restructuring discussions may be triggered by a deterioration or breach in "early warning" financial covenants under the lenders' finance documents that indicate the company is in financial difficulty, or by an impending liquidity shortfall. Financiers and companies will generally seek to negotiate and privately agree a restructuring outside of a

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26 This can also be contrasted with DOCAs, where trade, employee and other non-finance creditors are usually subject to the provisions of the DOCA.

27 The "out-of-court" terminology is derived from the United States, where the formal insolvency process for restructuring a company, Chapter 11 (11 USC §§1101–95), is subject to the control of the United States Bankruptcy Court. A consensual restructuring agreed outside of this formal process is therefore described as "out-of-court". The "out-of-court" terminology has been applied to describe consensual restructurings agreed outside a formal insolvency process in many other jurisdictions, including Australia, despite the fact that (counterintuitively) our formal insolvency processes have little court involvement, and our consensually agreed restructurings may still be implemented using a court-sanctioned scheme of arrangement procedure.

formal insolvency process because they take the view that a formal insolvency will result in negative publicity, disruption, increased cost and damage to the business, reducing its value and possibly threatening its ability to continue operating on a going concern basis at all.

As noted by Chris Howard and Bob Hedger:[28]

> Although a panoply of statutory techniques can be deployed when a company is in financial difficulties, the principal reason for undertaking an informal consensual restructuring is the potential for improved value recovery, flexibility, lower cost and expediency of the arrangements, both as to how the rescue is planned and implemented. Ultimately, it may not just be a question of losing flexibility: if the business of that company is based around the skills of the individuals who work within it then the public nature of a formal insolvency procedure will probably destroy value almost instantaneously. An informal restructuring avoids the need to adhere to a statutory timetable and the procedural formalities laid down by the statutory regimes which operate in a public goldfish-bowl. If publicity will impede implementation of a rescue, or further damage the trading position of the company, it will be preferable to use an informal arrangement as it should be easier to control disclosure of information.

(c) Restructurings generally only involve financial creditors, not trade creditors

It is implicit in the concept described above that restructurings will generally not involve trade creditors, employees or other (non-financial) creditors. Instead they will be negotiated and implemented between the company and its financial creditors.

The reason for this has been well explained by Professor Sarah Paterson as follows:

> … it is likely that the financial liabilities governed by [the company's financial] arrangements will be sufficient to absorb the losses on the balance sheet, so that there is no need to bring trade creditors into the restructuring plan. This has a number of advantages. Trade creditors may be smaller, less sophisticated players who have a more emotional response to loss than the large financial players, making it difficult to reach an accommodation with them. Furthermore, it reduces the number of parties to the restructuring negotiations, cutting down the cost and time taken to reach a settlement. Perhaps most critically of all, it preserves the company's cash flow by indicating to trade creditors that they have no reason to cease supply or to withdraw their custom, and it preserves the team of employees by indicating that they have no reason to seek employment elsewhere. As highlighted at the outset, as many modern companies are little more than 'a good idea, a handful of people and a bunch of contracts', preserving cash flows and people is likely to be a significant part of the restructuring implementation plan. Thus the restructuring negotiations become a horse trade amongst senior and junior creditors and the shareholders as to how the losses should be shared amongst them.[29]

Importantly, the financiers agree to a restructuring on this basis because they consider it is in their best interests to do so — even though this means that only financial creditors, not trade or other creditors, will take a "haircut" on their debt.

(d) The importance of liquidity

Therefore, for such a restructuring of this nature to be undertaken successfully, it needs to occur while the company has sufficient liquidity to be able to continue operating on a going concern basis and pay its trade creditors in the normal course.

Indeed, financial creditors recognising this dynamic will sometimes seek to support the company's liquidity position, and thereby buy more time to carry out the restructuring,

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28 Chris Howard and Bob Hedger, *Restructuring Law & Practice* (LexisNexis, 2nd ed, 2014) [1.16].

29 Sarah Paterson, 'Rethinking Corporate Bankruptcy Theory in the Twenty-First Century' (2016) 36(4) *Oxford Journal of Legal Studies* 697, 708.

through deferring scheduled payments of interest or principal under loan documents, or even by advancing additional amounts.[30]

(e) Right sizing the balance sheet

Generally the aim of a restructuring is to "right size" the company's balance sheet. In other words, the aim is to reduce the financial obligations to a level where they can be comfortably serviced by the company during the term of the loan (or bond), and that the loan (or bond) will be able to be refinanced upon maturity.

How much debt a company can comfortably carry will require financial assessment, including some form of valuation of the business as a whole, as well as its forecast earnings. This is a somewhat subjective exercise, where the company and financiers will likely engage financial advisors to help them determine the prospects of the business going forwards, its ability to service debt and its needs for additional capital.

(f) Debt for equity swaps

A classic tool for deleveraging a company's balance sheet is the "debt for equity swap", and this is a feature of many restructurings. The premise of the debt for equity swap is that if the company is no longer able to service its debts, and the value of the debt exceeds the value of the business, then:

- the shareholders no longer have any real economic interest in the company; and
- the financial creditors are economically the real owners of the company, as they stand to gain or lose depending upon how much the business or assets can be sold for.

The debt for equity swap recognises this economic reality, by extinguishing some or all of the debt of the company but in exchange granting the creditors ownership of some or all of the company.

(g) How are the creditors treated under the restructuring?

As noted at section 4.4(c) above, the assumption in a restructuring will be that any reduction in debt needs to come from the finance creditors. A key issue therefore is how will this loss be allocated between the financiers, and what (if anything) will they receive in return?

On the basis that a restructure of this nature is predominantly a consensual exercise, the answer depends very much on negotiations between the parties, and the facts of the individual case. However, restructurings generally proceed in accordance with certain broadly accepted principles or "restructuring market conventions" which operate with reference to the structure of the financing arrangements.

Where there is only one class of financial debt, then the answer is normally straightforward: all holders of the debt will be expected to participate on a *pro rata* basis in any required reduction of their debt, and accordingly will receive a *pro rata* share of any benefits in exchange for such reduction, including participating in any debt for equity swap.

However, where there are multiple classes or "layers" of financial debt the issue becomes more complex. In such circumstances, it is customary for the parties to assess where "value breaks" in the company's capital structure. This essentially means assessing how much would likely be realised on an insolvency sale or enforcement of the company (or its business or assets), and then determining, if the proceeds of such sale were applied in

[30] See further discussion in respect of liquidity issues and the role of priority "rescue" or "DIP" finance at section 8.4 below.

the applicable contractual or statutory priority, which financial debts (or equity interests) would:

- be paid in full (referred to as being "in the money");
- be partially paid (where "value breaks", the "fulcrum debt", "partially underwater" or "partially in the money"); and
- receive nothing (being "underwater" or "out of the money").

Generally the approach adopted in restructuring is that debt that "is in the money" should be kept whole under any restructuring and not suffer any compromise. The "fulcrum debt" will usually need to be partially reduced, but will be entitled to receive some or all of the equity of the restructured company in exchange (reflecting the concept they are the economic "owners" of the company). The debt (or equity) that is "underwater" should generally receive nothing in the restructured company, but will frequently receive or retain a small payment or debt or equity holding in the restructured company in order to obtain their consent to otherwise extinguish their claims under the transaction.

The implementation of these general restructuring principles in practice is considerably more complex and will, in most cases, be heavily negotiated. For example, there will frequently be debate as to the value of the company. Senior ranking creditors may be incentivised to argue for a lower valuation (so as avoid sharing value with lower ranking creditors or shareholders), whereas junior ranking creditors will argue for a higher valuation (so as to justify retaining some of their debt or participating in the equity). Furthermore, creditors and shareholders will argue as to who should get the benefit of any uplift in value resulting from a consensual restructuring rather than a formal insolvency — for example, if the restructuring cannot be undertaken without the consent of shareholders or junior creditors then they will argue for a share of this value, whereas senior creditors will argue that their seniority entitles them to the majority or all of such upside. The terms of the financial instruments and intercreditor agreements between the parties may also have a significant impact on the strength of the parties' respective positions and the course of any restructuring negotiations.

It is within the context of these dynamic and complex contractual and financial arrangements that the creditors' scheme of arrangement regime operates to facilitate and effect restructuring.

(h) What role does the creditors' scheme of arrangement have in this process?

The creditors' scheme of arrangement acts as a tool to bind all of a class of creditors to a deal. In many financial restructurings no creditors' scheme of arrangement will be required at all, because all of the creditors in the class will have agreed consensually to the restructuring and its terms can be documented contractually in the normal manner. In such circumstances the restructuring will be able to be achieved through a completely "out-of-court" and informal process.

However, and particularly for larger companies where the financial debt is more widely held, it may be difficult to achieve consensus. Furthermore, debt may trade during the course of negotiations such that new holders may take control of parts of the debt structure and have different requirements or objectives. In the case of some instruments, such as bonds held through clearing systems, it may be impossible to identify all of the underlying bondholders and it may therefore be impractical to deal with them individually.

In such complex cases a creditors' scheme of arrangement can be useful to implement a restructuring to bind all of the creditors in the class, including the minority that either disagree or that have not participated in the negotiation and/or formulation of the restructuring. This can be done provided the requirements of the creditors' scheme are satisfied, including approval by 75% by value of debt and a majority in number of the creditors in the class that attend the meeting and vote on the resolution.

The use of a formal creditors' scheme of arrangement process in a financial restructuring context therefore comes at the end of the "out-of-court" restructuring process, once all of the terms of the restructuring have been negotiated and agreed (at least in principle) between the respective groups (or members thereof), at which point it becomes necessary to bind all of the members of the relevant group to the terms of the restructuring. In this context the creditors' scheme of arrangement is a tool for the efficient and effective implementation of the restructuring process agreed (at least in principle) between the company and its finance creditors.

(i) Intra-class vs cross-class cram downs

It should be noted that whilst a creditors' scheme of arrangement can bind minority members of a class if the scheme is approved by the requisite majority of that class (referred to as an "intra-class cram down"), approval by one class of creditors will not bind another class of creditors unless the requisite majority of that class also votes in favour.

In other words there is no ability under a creditors' scheme of arrangement for the company and the fulcrum debt holders to bind an "out of the money" subordinate class to accept little or no return under the scheme without the consent of that class (referred to as a "cross-class cram down").

This is an important limitation on the extent to which creditors' schemes of arrangement can be used to bind dissenting creditors to a restructuring. We discuss the issues caused by this lack of cross-class cram down further at section 7 below.

4.5 The restructuring process where a creditors' scheme of arrangement is involved

The formal scheme process, outlined at section 4.2(b) above, only commences at the end of (what is sometimes) a lengthy process of negotiation and discussion, once the company and key supporting finance creditors have agreed the terms of a proposal. This highlights the challenge of determining when any moratorium which forms part of a scheme process should start.

The key stages of a financial restructuring implemented by a creditors' scheme of arrangement would typically involve (although the process in practice can vary significantly from company to company depending on the circumstances and stakeholders) the following elements:

- The process begins when the company or its financial creditors become concerned about the company's financial viability or ability to service its debts.
- At this time, the company, together with its financial advisers, will typically start to consider and evaluate what options it has to obtain additional liquidity, which may include seeking waivers or temporary deferrals, capital raises, asset sales, sale of the company as a whole or a refinancing of the company's debt.
- Depending on the severity of the company's financial predicament and particularly if there is doubt as to whether the available options will be successful, a company may seek to agree adjustments to its existing debt with its current financial creditors. This process may be run in parallel, or in conjunction with, one of the other options described above.
- Ideally the company will start discussing and negotiating these options with its financiers as early as possible to establish whether there is a commercially viable deal (including whether all of the necessary stakeholders to implement the proposal are willing to agree to it).
- Work will need to be undertaken by the financial creditors and the company to rigorously assess the company's financial position and the rights of the different key stakeholder groups. This will generally involve a significant amount of

financial and commercial information regarding the company being provided by the company to its financiers, and substantial review and advisory work being undertaken by the financial and legal advisors to the company and its financiers to understand the position and the options of the parties.

- Importantly, the company's debt servicing capacity, its new money needs and the insolvency "counterfactual" will need to be assessed to inform any proposals and negotiations as to the restructured balance sheet and the participations of the existing creditors and shareholders in that restructured company.
- The terms of the restructuring "deal" are worked up typically by way of "term sheets" to establish and negotiate the key financial and legal terms of the deal.
- In parallel, the financial creditor groups (in particular the senior creditors) may also develop their "plan b", or "non-consensual" option should it be impossible to reach a satisfactory agreement with shareholders or junior creditors (accepting the agreement of such parties is needed). This non-consensual option would typically look to undertake some form of (ideally rapid and light-touch) enforcement or insolvency process that would result in a sale of the group or its assets either to a third party buyer or the senior creditors themselves. This "next best option" would provide senior creditors with their "back stop" position when negotiating with more junior stakeholders.
- In contrast, junior stakeholders may develop plans or threats to disrupt any "plan b" enforcement by the senior creditors so as to increase the risk and cost to the senior creditors of taking such actions and thereby increase the bargaining leverage of the junior stakeholders for a larger "consent payment" as part of the restructuring.
- Where the financial creditors and the company are all in agreement on the terms of the restructuring, it may be possible to move straight to drafting and negotiating the "long form" legal documentation to give effect to its terms, and then to implement it by way of the parties simply signing the relevant contracts.
- However, generally, where there are numerous financial creditors, it will be harder to reach unanimous agreement. Therefore for a large syndicated facility agreement, where there are a lot of lenders, or a bond issuance, it would typically be difficult to achieve the consent of all holders required to undertake a debt restructuring. It is in this context that a creditors' scheme of arrangement becomes useful, as it provides a tool to impose the necessary agreement on all creditors in the class provided the scheme is approved by the requisite majorities.[31]
- In such circumstances, if a deal can be reached between the company and a sufficient number of the financial creditors in the relevant groups, the company will usually negotiate and enter into a restructuring support agreement (or similar implementation agreement or "lock-up" agreement). This will typically be signed by the company and an "ad hoc" group of supporting financier creditors who agree to support and vote in favour of the scheme. In many instances such agreement will include a contractual provision to prevent financial creditors from commencing enforcement proceedings or selling their debt (other than to supporting parties) while the agreed restructuring process is being implemented.
- Entry into the restructuring support agreement (or similar contractual arrangement) gives the company sufficient comfort that the creditors' scheme is likely to be approved by the requisite majorities and that it is worthwhile to

[31] In effect, a scheme reduces the consent threshold under finance documents from 100% of lenders or bondholders to 75% by value and a majority in number.

undertake the significant work involved in preparing the terms of the creditors' scheme of arrangement and explanatory statement, obtaining the independent expert's report, preparing for the first and second court hearing and holding the scheme meeting.

- The entry into a restructuring support agreement is typically publicly announced, and provides the company's other stakeholders (such as trade creditors, employees and shareholders) some information about the agreed restructuring and confidence that the creditors' scheme of arrangement (and broader restructuring) will be successfully implemented (noting also that the scheme process will also be public, and the announcement of which might, without context, otherwise give cause for concern as to the company's financial position).
- It is only at this point that the "formal scheme of arrangement" process begins that is described at section 4.2 above.

4.6 The rise of finance debt and the secondary debt markets

(a) Increase in debt finance

One of the important drivers of the rise of "out-of-court restructurings", including the use of creditors' schemes of arrangement, in Australia in the period post the 2008 Global Financial Crisis (**GFC**) has been the increase of companies with highly leveraged capital structures, and more broadly held debt through increased use of syndicated loan facilities and note or bond structures.[32] This has been a global phenomenon, not just in Australia.[33]

A key component of this has been the development and increased use of leveraged finance, including as part of leveraged buy outs by private equity funds.[34] The following was written in 2007, shortly before the GFC, but remains equally (or even more) relevant to current circumstances:[35]

> Debt is an integral element of private equity buyouts, serving both as a crucial means of finance and as a 'stick' motivating managers of portfolio companies. As the co-founder of Carlyle Group said in 2007, 'Cheap debt is the rocket fuel. We try to get as much as we can as cheaply as we can and as flexibly as we can.' With debt being both cheap and plentiful currently, the environment is ideal for private equity firms to do precisely this.

Leverage financing structures were already on the rise in Australia before the GFC.[36] Following the GFC there has also been an increasing trend of companies turning to the United States private placement, term loan B and high yield bond markets, resulting in

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32 For an illustration of the rise in bond issuance by listed Australian companies: see Ashley Fang, Mitch Kosev and David Walking, 'Trends in Australian Corporate Financing' (December 2015) *Reserve Bank of Australia Bulletin* 29, 36 <https://www.rba.gov.au/publications/bulletin/2015/dec/pdf/bu-1215-4.pdf>.

33 Guglielmo Maria Caporale, Suman Lodh, Monomita Nandy, 'How has the global financial crisis affected syndicated loan terms in emerging markets? Evidence from China' (2018) 23(4) *International Journal of Finance and Economics* 478; Jang Ping Thia, 'Bank Lending—What Has Changed Post-Crisis?' (Working Paper, April 2018) 7 https://www.aiib.org/en/news-events/media-center/working-papers/pdf/2018_April_Bank-Lending-Post-Crisis_AIIB-Working-Paper.pdf; Iñaki Aldasoro, Torsten Ehlers, 'Global liquidity: changing instrument and currency patterns' (September 2018) *BIS Quarterly Review* 17.

34 See generally Brian Cheffins and John Armour, 'The Eclipse of Private Equity' (Law Working Paper No 82/2007, European Corporate Governance Institute, April 2007), which discussed the development of the private equity model and the role played by leveraged finance in these transactions.

35 Brian Cheffins and John Armour, 'The Eclipse of Private Equity' (Law Working Paper No 82/2007, European Corporate Governance Institute, April 2007) 37.

36 Yuen-Yee Cho, Berkeley Cox and Richard Hayes 'Relying on debt' (2006) *International Financial Law Review* 34.

widely held debt by offshore holders.[37] These trends in leveraged markets have continued with the growth of Australian versions of these United States products and the development of the 'unitranche' debt structure in recent years.[38]

(b) Increase in secondary debt trading in Australia

As has been noted by a number of commentators,[39] secondary debt trading has seen significant growth in the Australian market since the GFC. Specialist distressed investment funds have acquired significant portions of the debt holdings, and played significant roles in the restructurings of the majority of Australian companies that have restructured by way of creditors' schemes of arrangement during this period, including Alinta Energy, Centro Properties, Nine Entertainment, Boart Longyear, Emeco, Slater & Gordon, Bis Finance and Quintis.

The involvement of secondary debt investors in the Australian distressed situations market has generally been a positive development, which has facilitated turnaround and corporate recovery. Distressed debt investors generally look to maximise their return on investment through converting some or all of their debt to equity, and then maximising the value of that equity through a turnaround of the company over a longer time horizon. As noted by William Stefanidis:[40]

> A prominent feature of many [distressed debt investor (DDI)] ventures is that the upside sought by the purchaser of the debt is ultimately obtained in the form of equity. It follows that the DDI's return is made where a long-term turn-around is achieved. This incentive fundamentally aligns the interests of DDIs and distressed corporations towards the longevity and economic prosperity of a company. It opens a door of opportunity for those with sufficient risk appetite where there would otherwise be none, particularly where a primary lender's patience and risk appetite is nearing its end.
>
> This alignment of financial incentives between DDIs and distressed companies can yield a range of benefits in corporate restructure, including:
>
> - expertise in the management and operation of a distressed company, which can assist in the turn-around;
> - additional funding, whether through taking an additional equity stake or a loan convertible to equity in the future, which is often needed urgently by distressed companies to overcome imminent difficulties; and
> - having a vested interest in long-term success, the risk that a senior lender (whose patience has expired) will seek immediate recovery of its outstanding loan for breach of covenant is diminished.

The existence of a pool of distressed investors who are willing purchasers of debt in the secondary markets has provided opportunities for Australian banks and other "par lenders" to exit from distressed situations quickly. The depth and competitiveness of the secondary market has allowed par lenders to recover a market priced amount for their debt, without the need to carry out an enforcement or sale process (with the attendant potential negative consequences).

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37 Anna-Marie Slot, Jamie Ng and Paul Jenkins 'Spotlight on a nascent market' (2015) *International Financial Law Review* 59.

38 Yuen-Yee Cho, 'Year in Review: Key trends in the Australasian leveraged loan market' *King & Wood Mallesons* (Blog Post, 13 December 2019 <https://www.kwm.com/en/au/knowledge/insights/leveraged-finance-summary-20191212>.

39 William Stefanidis, 'Reviving the Incentive to Compromise in Corporate Restructure: The Role of Secondary Debt Markets' (2017) 28(2) *Journal of Banking and Finance Law and Practice* 135, 138; Adam Watterson, 'Pulling back the shares: Demystifying vulture funds' (2016) 27(2) *Journal of Banking and Finance Law and Practice* 131, 132–3; Ashurst and PriceWaterhouseCoopers, *Distressed Investing in Australia – A guide for buyers and sellers 2011* (Report, 2011).

40 William Stefanidis, 'Reviving the Incentive to Compromise in Corporate Restructure: The Role of Secondary Debt Markets' (2017) 28(2) *Journal of Banking and Finance Law and Practice* 135, 138–9.

Australia's existing creditors' scheme of arrangement procedure is an attractive part of our insolvency and restructuring regime to distressed debt investors and other secondary acquirers of debt, for a number of reasons, including that it is much the same as the UK creditors' scheme of arrangement with which they are familiar, the clarity, predictability and fairness of its operation and its ability to help facilitate restructurings and turnarounds (in the manner described at section 4.4 above) in a non-disruptive and therefore value preserving manner.

4.7 Orders to restrain proceedings under section 411(16)

(a) Stay orders under section 411(16)

Section 411(16) of the Corporations Act gives the Court a broad judicial discretion to grant a stay in connection with a scheme of arrangement.[41] It states:

> Where no order has been made or resolution passed for the winding up of a Part 5.1 body and a compromise or arrangement has been proposed between the body and its creditors or any class of them, the Court may, in addition to exercising any of its other powers, on the application in a summary way of the body or of any member or creditor of the body, restrain further proceedings in any action or other civil proceeding against the body except by leave of the Court and subject to such terms as the Court imposes.

As explained by Black J in *Re Boart Longyear Ltd* [2017] NSWSC 537 at [10]–[11] (***Re Boart***), the purpose of this section is to seek to promote the orderly conduct and consideration of a scheme of arrangement which may bring about a compromise of claims of creditors.

It seems that the Courts now consider that an order under section 411(16) provides for a stay of any action or civil proceedings against the scheme company, whether or not such action or proceeding has already been commenced.[42] However there has been conflicting authority on this point. In *Re Reid Murray Acceptance Ltd* [1964] VR 82 it was held that the Court's jurisdiction to restrain "further proceedings" was limited to proceedings which have actually commenced. By contrast, *Re Glencore Nickel Pty Ltd* [2003] WASC 18 (***Re Glencore***) held that the Court's jurisdiction extended to proceedings that have not been commenced. In *Re Boart*, Black J agreed with *Re Glencore*, which his Honour thought was consistent with the language and the purpose of section 411(16), and also with the trend in modern international insolvency practice to recognise the risks of multiple proceedings which do not involve any form of collective resolution of claims against a company that is in financial difficulty.[43]

(b) Orders may be made where a scheme is "proposed"

Section 411(16) is potentially available to a scheme company if it can be established that a scheme of arrangement has been "proposed".

It is not always easy to discern whether a particular scheme has been sufficiently "proposed" to enliven the availability of the section 411(16) stay.[44] However, this issue has been considered in a number of court decisions and some guiding principles have emerged.

In *Re GAE Pty Ltd* [1962] VR 252, Sholl J (at 255–6) articulated the following general principles in relation to the application of the predecessor of section 411(16):

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41 *Re Clements Langford Pty Ltd* [1961] VR 453, 456.

42 *Re Boart Longyear Ltd* [2017] NSWSC 537, [11].

43 *Re Boart Longyear Ltd* [2017] NSWSC 537, [11].

44 A fact acknowledged by Master Evans in *Playcorp Pty Ltd v Venture Stores (Retailers) Pty Ltd* (1992) 7 ACSR 193, 195 and also by Black J in *Re Boart Longyear Ltd* [2017] NSWSC 537, [12].

- it cannot be said that a compromise or arrangement "has been proposed" within the meaning of section 411(16) when the idea of the compromise or scheme of arrangement is still private and knowledge of it is limited to the company or its own agents;
- it is necessary that the proposal should be known publicly, or at least to one or more of the creditors or class of creditors who would be affected — if knowledge of the proposal is limited to the company or its solicitors that will be insufficient, although the dispatch of the scheme booklet to creditors is not necessary to enliven section 411(16);
- it is not necessary for all creditors who might be affected to be aware of the proposal of the scheme;
- it is not necessary for the scheme to be in a complete form, capable of being sent with notices of meetings and other statutory requirements; and
- the general principles of the scheme must be defined and "at a stage at which the Court would be justified in ordering a meeting of creditors", despite the fact that additional details such as schedules of creditors and their debts might need to be included.

Later, in *Playcorp Pty Ltd v Venture Stores (Retailers) Pty Ltd* (1992) 7 ACSR 193, Master Evans made it clear that a scheme had been "proposed" for the purposes of section 411(16) if a genuine proposal in an advanced form exists and the draft explanatory statement had been delivered to ASIC for its review.

(c) Section 411(16) orders are fairly rare

As noted in section 4.2, a section 411(16) stay is a relatively rare feature of creditors' schemes of arrangement. Out of the 19 creditors' schemes which have been implemented since 2008, only 3 of them featured a section 411(16) stay. In this regard, it should be noted that in 5 of the schemes summarised, a section 411(16) stay was not required as the company was already in either administration or liquidation.

An additional reason why section 411(16) stays have been relatively rare in creditors' schemes is that, in general, the finance debt will generally already be subject to some form of explicit or de facto standstill regime under the terms of the contractual agreement between the parties. This may be because a company in distress is often able to negotiate a standstill arrangement with key supporting finance creditors, or because most syndicated loan or bond documentation includes a collective acceleration and security enforcement regime which provides that a majority of lenders or bondholders must instruct any acceleration or security enforcement.

In addition, intercreditor and subordination documentation typically contain restrictions preventing junior finance creditors from accelerating, making demands, taking enforcement action or otherwise winding up companies unless the senior debt creditors have been paid out (or until the standstill period provided for in such documentation has expired).

4.8 Comparison between creditors' schemes of arrangement and DOCAs

As noted above, in addition to restructurings undertaken using a creditors' scheme of arrangement, a company in financial distress has the option of effecting a restructuring by using the administration regime in Part 5.3A of the Corporations Act by appointing administrators, and the proposal and implementation of a DOCA.

The administration and DOCA process was introduced into the Corporations Act following the Harmer Report[45] in 1993, which provided a comprehensive "root and branch" review

[45] Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 13 December 1988).

of the operation of Australia's insolvency laws. The Harmer Report envisaged the voluntary administration regime would be:

> …a new voluntary procedure for insolvent companies which integrated the procedures for the voluntary winding up of a company and for a scheme of arrangement. The procedure was designed with the aim that it would be
>
> - capable of swift implementation
> - as uncomplicated and inexpensive as possible and
> - flexible, providing alternative forms of dealing with the financial affairs of the company.[46]

The Harmer Report further noted in respect of DOCAs:

> ***Deed of company arrangement***: If a deed of company arrangement is agreed, it will be a simplified document of much less size and complexity than the present forms of 'scheme document' that oppress creditors and others. The deed will incorporate (by simple reference) standard provisions contained in a schedule to the companies legislation, as well as many provisions of the legislation dealing with, for example, admissible claims, order of distribution to creditors and avoidance of antecedent transactions (such as preferences and similar voidable transactions).[47]

A key feature of DOCAs and a distinction between them and creditors' schemes of arrangement is that a DOCA can only be undertaken following the appointment of an administrator to the company.[48] The directors of a company may only appoint an administrator where they have formed the opinion and resolved that the company is insolvent or likely to become insolvent at some future time.[49] A creditors' scheme of arrangement in contrast can be proposed where the company is not subject to any insolvency process (and thus not requiring the directors to specifically resolve that the company is insolvent or likely to become insolvent). A creditors' scheme of arrangement is also available where the company is under administration (even though this is rarely used in this context)[50] or liquidation.

A further key distinction between the administration and DOCA process and a creditors' scheme of arrangement is who controls the company during the implementation process. During an administration, the third party administrator has control of the company's affairs and is taken to be acting as the company's agent.[51] A transaction or dealing affecting property of the company is void unless entered into by the administrator on the company's behalf, the administrator had consented to it in writing or it was entered into under an order of the Court.[52]

In terms of the length of the process and the time and costs of implementation, the creditors' scheme of arrangement process can be comparatively lengthy and complex compared to a restructure by DOCA (as envisaged by the Harmer Report).

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46 Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 13 December 1988) [54].

47 Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 13 December 1988) [56].

48 Creditors vote upon any proposed DOCA at the second meeting of creditors in an administration: *Corporations Act 2001* (Cth) ss 439A, 444A.

49 *Corporations Act 2001* (Cth) s 436A(1).

50 The one example of which we are aware of the creditors' scheme of arrangement in respect of Quintis – see section 4.3 above. As noted by Jason Harris in his thesis, 'Promoting an optimal corporate rescue culture in Australia: The role and efficacy of the voluntary administration regime' (PhD Thesis, University of Adelaide, 2021), the administration regime is not well aligned to cater for creditors' schemes of arrangements given the short default time period for administrations, and the fact that there is no provision for creditors to vote in favour of a creditors' scheme of arrangement at the second meeting of creditors.

51 *Corporations Act 2001* (Cth) ss 437A–437B.

52 *Corporations Act 2001* (Cth) s 437D.

A significant part of this time and cost is generally attributable to complexity of the company's financial arrangements and operations that need to be restructured, and the often lengthy negotiations between a company and its creditor groups in the lead up to the implementation of a creditors' scheme. By comparison a restructure by DOCA will generally be quicker (as it is bound by the time limits imposed on the administration process) and the documentation for a DOCA tends to be significantly shorter and less complex.

For many companies the costs involved in a creditors' scheme of arrangement (which include two court hearings, a formal meeting, production of a detailed and lengthy explanatory memorandum and an independent expert's report) will be disproportionate to the size of the company, and the simpler DOCA process is more appropriate. However, the benefits of a creditors' scheme of arrangement is certain context can justify the higher costs and time commitment.

Set out below is a high-level comparison of some of the key features of creditors' schemes of arrangement and restructuring using DOCAs, highlighting the different roles these regimes play in providing restructuring options under the regimes available in Australia:

Feature	DOCAs	Creditors' schemes of arrangement
"Insolvency" process?	Yes	Not necessarily
Does the company have to appoint an administrator/independent third party insolvency practitioner?	Yes	No
Debtor-in-possession?	No	Potentially[53]
Moratorium?	Broad automatic moratorium (during administration, and can be extended during period of DOCA)[54]	Court may stay further proceedings pursuant to section 411(16)
Creditor voting thresholds	Majority of creditors present and voting by number and value voting as one class	Majority of creditors voting by number holding 75% of the value of debts – on a class-by-class basis
Court approval required?	No	Yes

[53] Generally in the restructuring context creditors' schemes of arrangement are proposed by a company outside of administration or liquidation. Accordingly, they could be loosely described as debtor-in-possession processes in those circumstances.

[54] *Corporations Act 2001* (Cth) ss 440A–440D.

Feature	DOCAs	Creditors' schemes of arrangement
Ability to bind secured creditors?	Limited – a secured creditor that did not vote in favour of a DOCA will remain entitled to realise its security[55]	Yes – once the scheme has been approved by the court, it binds all relevant creditors, including creditors who voted against the scheme (or who did not vote at all), whether or not those creditors are secured
Ability to release third parties (eg guarantors)?	No	Yes
Impact on trade creditors?	Administration stay affects trade creditors, and DOCA typically compromises trade creditor claims	In a restructuring context typically there is no stay on trade creditors, and typically the creditors' scheme of arrangement does not affect trade creditors
Potential impact on value of the business	Given the need for the company to enter into administration, and the consequential loss of control over the company, administration and DOCAs can be seen as having a potentially destructive impact on value	Given much of the negotiation occurs prior to the commencement of the formal process schemes can be seen as "lighter touch", which may, arguably, be seen as having less detrimental impact on value

4.9 Why are there so few creditors' schemes of arrangement in Australia?

To understand why there are a comparatively small number of creditors' schemes of arrangement in Australia, as against other formal restructuring processes such as administration and DOCAs, it is important to have regard to the role that creditors' schemes of arrangement play.

As discussed in section 4.4 above, creditors' schemes of arrangement are generally used in the restructuring context as means for the implementation of a broadly consensual "out-of-court" restructuring process that tends to be favoured where an otherwise viable company is overleveraged.

Where the debt that is to be restructured involves a large number of holders, the creditors' scheme of arrangement provides a very useful tool to ensure that any dissenting (or non-participating) minority is able to be bound to the agreed restructuring deal on the same terms.

[55] Subject to the ability of the DOCA to extinguish the debt underlying the secured claim as held in *Re Bluenergy Group Ltd* [2015] NSWSC 977.

In the Australian market, there are a limited number of companies which have the amount of finance debt, with the number of holders, for this restructuring strategy to be viable.

In addition, as has been recognised for many years, the cost and timeframes involved in a creditors' scheme of arrangement make it unsuitable for many companies – for example, it was noted in the Harmer Report:[56]

> The procedure for a scheme of arrangement is cumbersome, slow and costly and is particularly unsuited to the average private company which is in financial difficulties. The time taken to implement a scheme varies but in general is at least two to three months. The legal and accountancy costs of even a relatively straightforward scheme are substantial.

For that reason the Harmer Report recommended the introduction of the simplified DOCA process, and that schemes of arrangement "be preserved for, in particular, larger private or public companies."[57]

Furthermore, economic conditions in Australia have been remarkably benign, particularly over the last decade. Interest rates have been at historic lows throughout this period, and financing (for large corporates in particular) has been readily available from multiple channels. Corporate distress has therefore been low, and largely focussed in certain sectors suffering specific issues (such as distress in the mining and mining services sectors in the 2015-2018 period in large part attributable to lower commodity prices).

In addition, there continue to be many companies that do not address their financial problems early enough. In such cases the level of financial distress may reach such a level that a restructuring of the finance debt, by itself, becomes insufficient, or too late to avoid a formal insolvency process such as administration or enforcement.

When assessed in context, the TMA does not think that the number of creditors' schemes of arrangement in Australia is "too low", or that there is any significant "untapped demand" for the use of creditors' schemes of arrangement in Australia that is frustrated by some defect in the legislation (such as lack of a broader moratorium). It would, in the TMA's submission, not be an accurate comparison to directly assess the number of creditors' schemes of arrangement against the prevalence of administration and DOCAs as a measure of their comparative effective or role within the restructuring landscape in Australia.

Similar dynamics to those described above apply to other jurisdictions that have creditors' schemes of arrangement, and therefore constrain their use to similar circumstances.

It is acknowledged that there are significantly more creditors' schemes undertaken in the UK than in Australia, but this is driven by the fact that London is the world's largest international finance hub. Large syndicated loans and bond issuances by companies located across Europe and around the world are governed by English law. Where these loans become distressed and need to be restructured, the restructuring negotiations are generally carried out by English lawyers. The creditors' scheme of arrangement under English law will generally be available in such circumstances, and binding on the relevant financial creditors. Generally, creditors' schemes in the UK will deal only with financial creditors. Where a company is unable to pay its trade creditors, it would be more typical for an administrator to be appointed and the business sold.[58]

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56 Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 13 December 1988) [46].

57 Law Reform Commission, *General Insolvency Inquiry* (Report No 45, 13 December 1988) [56]–[57].

58 UK company voluntary arrangements (which have some similarities to Australian DOCAs, but are typically used outside of administration) have also frequently been used in the UK to compromise lease liabilities. Initial cases under the new "restructuring plan" procedure in the UK suggest that this may also be used to compromise lease and trade liabilities in some cases. See further discussion in respect of restructuring plans at section 5.4(g) below.

There is no equivalent international finance market in Australia, and therefore, Australian creditor's schemes of arrangement are largely left to operate within the Australian domestic market.[59]

4.10 Impact of the introduction of the safe harbour regime

The protection for directors engaging in an out-of-court restructuring (whether involving a creditors' scheme of arrangement or otherwise) was bolstered by the introduction of the insolvent trading "safe harbour" regime in 2017.[60]

The safe harbour regime provides a director with protection from civil liability for insolvent trading under section 588G of the Corporations Act provided that the director develops or takes one or more courses of action that are reasonably likely to lead to a better for the company than the immediate appointment of an administration or liquidator to the company.[61]

TMA considers the safe harbour reforms to have been a positive development for restructurings in Australia, and to have been a further factor that has helped to encourage directors to pursue an 'out-of-court' restructuring of the type discussed at section 4.4 where that delivers a better outcome. That being said, there is little data on the operation of the safe harbour regime to date, and these views are largely based on the anecdotal experiences of TMA members.

It is noted that the operation of the insolvent trading safe harbour will be canvassed in the contemporaneous safe harbour review that is currently underway.[62]

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59 It is also notable that creditors' schemes of arrangement under the Corporations Act can only apply to a "Part 5.1 body", being a "company" or a registrable body that is registered under Division 1 or 2 of Part 5B.2: *Corporations Act 2001* (Cth) s 9 (definition of "Part 5.1 body").

60 See *Corporations Act 2001* (Cth) pt 5.7B div 3 subdiv C; Paul Apáthy, Sarah Spencer and Leyton Cronk, 'Revised and Improved: New Insolvent Trading Safe Harbour and Ipso Facto Legislation Passes Through the Senate', *Herbert Smith Freehills* (Blog Post, 15 September 2017) <herbertsmithfreehills.com/latest-thinking/revised-and-improved-new-insolvent-trading-safe-harbour-and-ipso-facto-legislation>.

61 *Corporations Act 2001* (Cth) s 588GA.

62 The Treasury, 'Review of the insolvent trading safe harbour', *Reviews* (Web Page, 3 September 2021) <https://treasury.gov.au/consultation/c2021-205011>.

5 International case studies in respect of creditors' schemes of arrangement

5.1 Overview

(a) Relevance of international case studies

When considering possible reform of creditors' schemes of arrangement in Australia the TMA believes it is important to consider the operation of creditors' schemes of arrangement in other countries.

Schemes of arrangement are included in the corporations legislation of many countries with an English common law heritage, and all such regimes were originally based on the UK scheme of arrangement provisions in place when they were enacted.

With the increased use of creditors' schemes of arrangement to aid "out-of-court" restructurings in jurisdictions around the world, there has already been consideration of these issues in other countries, and law reforms enacted, with the intent of updating the scheme of arrangement procedure to better facilitate this growing usage. These law reform experiences provide useful guidance for the Australian experience.

(b) Singapore and UK reforms to creditors' schemes of arrangement

Singapore and the UK are the two foreign jurisdictions that have done the most in recent years to update creditors' schemes of arrangements to better support restructuring. In this section we summarise the key reforms made in each of those jurisdictions for that purpose, and provide some comment on the success of those reforms in practice.

Our commentary on the reforms in Singapore and the UK has been considerably aided by conversations between the TMA members who prepared these submissions and restructuring professionals operating in each of those markets who shared their insights and frank appraisals as to what does and does not work, and ultimately what lessons Australia should take when considering reforms here. We thank all of the professionals who assisted us in this endeavour.

(c) Singapore reforms

In section 5.3 below we discuss the sweeping reforms recently undertaken in Singapore with the aim of making Singapore an international debt restructuring hub. Key to these reforms were a number of changes to Singapore creditors' schemes of arrangement, including the introduction of an enhanced moratorium where a company "intends" to propose a scheme, cross-class cram downs, priority rescue financing, pre-packaged schemes of arrangement and expansion of scheme jurisdiction to foreign companies.

Whilst the reforms were ambitious and broad-ranging, their reception and success has been mixed. There is concern, in particular, that the enhanced moratorium has led to abuse by debtor companies due to its easy accessibility and the lack of oversight over, or disclosure by, the company. There are a number of examples where companies have been given a "long leash" by the court whilst failing to meaningfully engage with their financial stakeholders for an extended period, during which value, and stakeholder recoveries, have diminished.

It also appears that Singapore's adoption of a cross-class cram down is not particularly effective for a number of reasons including the fact it does not provide for shareholder cram downs. To our knowledge it has not been used at all. The Singapore rescue

financing regime has seen some use, but it is unclear if it delivers substantive benefits in practice.

(d) UK reforms

In section 5.4 below we discuss two key UK reforms included as part of the recently enacted the *Corporate Insolvency and Governance Act 2020* (UK) (**CIGA**). The first is a "standalone" debtor-in-possession moratorium intended to give companies some breathing space to pursue a restructuring by way of one of a number of pathways. The second is the introduction of the "restructuring plan": a new process closely modelled on the existing creditors' scheme of arrangement, but which includes a cross-class cram down mechanism which can be used in respect of both creditors and shareholders.

The moratorium process has seen little use since its introduction, which appears to be due to restrictive qualification criteria and a number of technical issues making its use quite problematic in practice. It has not been used in conjunction with any schemes of arrangement or restructuring plans, but rather has seen very limited usage by SME sized companies.

The restructuring plan, in contrast, appears to have been quite successful to date, having already been used to effectuate a number of major restructurings in the UK and European market, including several cases where the new cross-class cram down power has been used. It seems to be generally well regarded by UK restructuring professionals.

5.2 Use of creditors' schemes of arrangement outside of Australia

Schemes of arrangement originated in the UK in 1870, as a measure to codify the court's power to approve a scheme of arrangement for a company in liquidation. Subsequently, companies which were not in liquidation began entering liquidation in order to take advantage of the 1870 legislation and enter compromises with their creditors. The legislation was subsequently amended to allow for a much greater range of transactions, as a more appropriate vehicle for the restructuring of a company than the liquidation process.

The UK legislation was followed closely in Australia, with Queensland inserting equivalent provisions to the UK Act of 1870 in 1889, and New South Wales and Victoria following in 1892. Schemes legislation has also been adopted in New Zealand, Hong Kong, Singapore, Malaysia, India and South Africa (among others).

In general, schemes of arrangement legislation in common law countries has remained relatively similar. Since the GFC, however, there has been an increase in law reform efforts towards improving schemes legislation, in part because of their increased use as a restructuring tool. This has led to divergences between scheme legislation overseas and provides useful guidance for potential reform in Australia.

5.3 Singapore

(a) Singapore restructuring law reforms

There has been a broad push by the Government of Singapore (**Singapore Government**) to establish Singapore as a regional hub for debt restructuring through a series of law reforms and associated measures.[63]

The origin of the reforms dates back to 2010, when the Singapore Ministry of Law convened the Insolvency Law Reform Committee (**ILRC**) (a committee of insolvency practitioners, academics and other stakeholders) to review Singapore's bankruptcy and

[63] Paul Apáthy and Emmanuel Chua, 'Singapore unveils major debt restructuring law reforms', *Herbert Smith Freehills* (Blog Post, 16 November 2016) <https://www.herbertsmithfreehills.com/latest-thinking/singapore-unveils-major-debt-restructuring-law-reforms>.

corporate insolvency regimes. In 2013, the ILRC prepared a report making wide ranging recommendations in connection with Singapore's corporate insolvency and bankruptcy laws. The ILRC's recommendations included enhancements to rescue mechanisms and the adoption of the UNCITRAL Model Law on Cross-Border Insolvency (the **UNCITRAL Model Law**).[64]

In 2016, the Singapore Government commissioned the *Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring,* which was tasked with recommending legal reforms that should be undertaken to enhance Singapore's effectiveness as a centre for international debt restructuring. The findings of the report culminated in the passage of the *Companies (Amendment) Act 2017* (Singapore) (the **Singapore Amending Act**), which introduced sweeping changes to Singapore's existing scheme of arrangement procedures. The *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) (**IRDA**) was subsequently introduced in 2018 to consolidate the provisions on insolvency, restructuring and dissolution applicable to corporate entities and individuals into a single omnibus enactment.

Prior to the reforms, creditors' schemes of arrangement in Singapore were very similar to those in Australia. The changes to Singapore's scheme of arrangement regime included the following main components:

- an expanded jurisdiction for foreign companies to utilise Singaporean schemes of arrangement;
- an enhanced moratorium which was made available upon proposing a scheme;
- the ability to cram down dissenting creditor classes;
- allowing 'debtor in possession' priority funding to be obtained by a company during the scheme process; and
- "pre-packaged" schemes that could be implemented without convening scheme meetings.[65]

A more detailed summary of the changes introduced to Singapore's creditors' schemes of arrangement are contained in 'Singapore's new "supercharged" scheme of arrangement',[66] a copy of which is appended to these submissions for ease of reference.

We discuss the Singapore creditors' scheme of arrangement moratorium, cross-class cram down and rescue financing mechanics introduced under these reforms in more detail in the following sections.

(b) Singapore scheme moratorium

The Singapore Amending Act introduced a two stage moratorium procedure specifically linked to creditors' schemes of arrangement.

Interim moratorium

Under the first stage of the Singapore moratorium, companies that propose, or intend to propose, a creditors' scheme of arrangement are automatically granted an interim thirty day period (the **Automatic Moratorium Period**) upon filing an application with the Court

64 Committee to Strengthen Singapore as an International Centre for Debt Restructuring, *Report* (Report, 20 April 2016) 5.

65 Paul Apáthy and Emmanuel Chua, 'Singapore's new "supercharged" scheme of arrangement' (2017) 18(5) *Insolvency Law Bulletin* 98, 98.

66 Paul Apáthy and Emmanuel Chua, 'Singapore's new "supercharged" scheme of arrangement' (2017) 18(5) *Insolvency Law Bulletin* 98.

for moratorium orders (such moratorium orders, if granted, would then be for a longer period from the time it was granted).[67]

During the Automatic Moratorium Period:

- no order can be made and no resolution may be passed to wind up the company;
- no receiver or manager may be appointed to the company's property;
- no proceedings may be commenced or continued against the company without leave of the Court;
- no execution, distress or other legal process may be commenced or continued against the company's property;
- no step may be taken to enforce any security over the company's property; and
- lessors are prevented from exercising any right of re-entry or forfeiture in respect to premises occupied by the company.

The interim moratorium applies to all creditors of the company (not just those subject to the proposed scheme of arrangement).

At the time of filing its application (at the start of the Automatic Moratorium Period) the company must also file with the Court the following information:

- evidence of support from the company's creditors for the intended or proposed compromise or arrangement, together with an explanation of how such support would be important for the success of the intended or proposed compromise or arrangement;
- in a case where the company has not yet proposed a compromise or arrangement to the creditors or class of creditors, a brief description of the intended compromise or arrangement, containing sufficient particulars to enable the Court to assess whether the intended compromise or arrangement is feasible and merits consideration by the company's creditors;
- a list of every secured creditor of the company; and
- a list of all unsecured creditors who are not related to the company or, if there are more than 20 such unsecured creditors, a list of the 20 largest unsecured creditors by value.[68]

Moratorium order

Upon hearing the moratorium application, the Court may make orders granting a further moratorium.

The Court may make orders granting protection against any of the following enforcement actions:

- winding up of the company;
- appointment of a receiver or manager over any property of the company;
- commencement or continuation of proceedings against the company;
- execution or distress against the company;

67 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) ss 64(8), (14).

68 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 64(4).

- enforcement of security over the company's property or repossession of goods; and
- the exercise of any right of re-entry or forfeiture under any lease in respect of premises occupied by the company.[69]

There is no requirement that the moratorium order be limited to those creditors who are subject to the proposed scheme of arrangement or that the extension be for any set period. In practice it seems that the Singapore courts have generally granted broad moratorium orders affecting all creditors in respect of all of the matters set out above (although on occasion certain secured creditors have been excepted from the scope of the moratorium order).

The moratorium order (but not the interim order) is expressly intended to have extra-territorial application, applying to any person within the Court's jurisdiction, whether the action occurs in Singapore or elsewhere.[70] This needs to be specifically applied for (ie must be with respect to a specific act or acts of a specific party who is in Singapore or within the jurisdiction of Singapore).[71]

Where the Court has made moratorium orders in respect of a company under section 64 of the IRDA, a subsidiary, holding company or ultimate holding company of that company can seek an order extending the moratorium to that related entity.[72] Practitioners in Singapore, spoken to by the TMA, have noted that this provision has been utilised often and is especially useful for group restructures.

There is no limitation on the period of any moratorium granted under section 64, or on the number of extensions that may be granted to such moratorium.

Court guidance on moratorium applications

The Supreme Court of Singapore has recently issued a *Guide for the Conduct of Applications for Moratoria under Sections 64 and 65 of the Insolvency, Restructuring and Dissolution Act 2018* (the **Moratoria Guidance**),[73] which contains guidance on the Court's requirements where moratorium applications are made. The Moratoria Guidance includes requirements in respect of (among other things) notice requirements to creditors when making a moratoria application, provision of "milestones" in respect of the restructuring exercise, full and frank disclosure to the court of all material facts and any creditor opposition, provision of an undertaking to actually apply to the court in respect of a scheme of arrangement as soon as practicable, establishing the need for the moratorium and requiring the company to undertake active discussions with creditors.

Information to be provided to creditors

Where a moratorium order is made, the Court must order the company to submit to the Court, within such time as the Court may specify, "sufficient information relating to the company's financial affairs to enable the company's creditors to assess the feasibility of the intended or proposed compromise or arrangement".[74]

Such information may (but is not required to include) the following:[75]

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69 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 64(1).

70 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 64(5).

71 *Re IM Skaugen SE* [2018] SGHC 259, [86].

72 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 65(1).

73 Supreme Court of the Republic of Singapore, Registrar's Circular No. 1 of 2021, *Guide for the Conduct of Applications for Moratoria under Sections 64 and 65 of the Insolvency, Restructuring and Dissolution Act 2018* (10 February 2021).

74 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 65(6).

75 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 65(6).

- a report on the valuation of each of the company's significant assets;
- if the company acquires or disposes of any property or grants security over any property — information relating to the acquisition, disposal or grant of security, such information to be submitted not later than 14 days after the date of the acquisition, disposal or grant of security;
- periodic financial reports of the company and the company's subsidiaries; and
- forecasts of the profitability, and the cash flow from the operations, of the company and the company's subsidiaries.

Whilst there is no explicit statutory requirement to provide such information where the Court makes an order to extend the moratorium, we understand that in practice Singapore Courts may make orders requiring further information to be provided upon the granting of an extension where they consider this appropriate.[76]

Restrictions and creditor protections associated with the moratoriums

Generally (and subject to the comments below), there are no restrictions on the conduct of the company trading on its business during the moratorium period. Accordingly, the company remains free to make payments, dispose of property or grant security in the normal manner.

However, the Court may, on an application of a creditor during the moratorium, make orders restraining the company from:[77]

- disposing of its property other than in good faith and in the ordinary course of the business; and
- transferring any share in, or altering the rights of any member of, the relevant company.

In addition, the Singapore scheme of arrangement regime is entirely silent on the status of creditors whose debts are incurred or paid during the moratorium period (except where a rescue financing order is made, as discussed below). It would therefore appear, that at least in theory, payments made by the company during the moratorium period could be subject to claw back as voidable transactions should the company subsequently enter liquidation. However, we understand that in practice voidable transactions are not pursued by liquidators in Singapore as vigorously as they are in Australia, and therefore we gather that this issue does not appear to have been a significant cause of concern in Singapore to date.

(c) Singapore scheme cross-class cram down

As part of the same law reforms, cross-class cram down provisions were also introduced that could be utilised as part of a creditors' scheme of arrangement.

These cross-class cram down provisions, now contained in section 70 of IRDA, were modelled on section 1129 of Title 11 of the United States Code (**US Bankruptcy Code**).[78] In broad terms, these provisions were intended to allow a Court to approve a scheme of arrangement notwithstanding that a class of creditors has not approved the scheme (subject to appropriate safeguards to ensure that the dissenting class of creditors are not prejudiced).

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76 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 64(7).

77 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 66(1).

78 See Insolvency Law Reform Committee (Singapore), *Final Report* (4 October 2013) [46]–[53].

Policy behind Singapore cross-class cram down

The ILRC considered the following arguments in favour of introducing the cross-class cram down:

(1) A minority of creditors in a dissenting class should not be able to veto a scheme merely because they are in a separate class, provided that they are treated fairly under the proposed scheme. Otherwise, a single dissenting class may hold the entire scheme ransom to the prejudice of the vast majority of creditors who support the scheme.

(2) Where the dissenting creditors get at least as much under the rescue plan as they would in liquidation, and are not being otherwise discriminated against, they cannot complain that the scheme is unreasonably imposed on them. Often, much of the dissention arises from creditors who merely wish to improve their bargaining position in order to obtain a greater share of the dividends.

(3) At present, there are cases where parties have spent much time and costs over the classification of creditors. Providing for a cram down mechanism may help to avoid excessive emphasis on the classification exercise.[79]

For these reasons, the ILRC supported the introduction of a cross-class cram down mechanism. However, the ILRC also recommended that, to better protect the rights of all creditors and to allow the court to check against abuse of cram down provisions and unreasonable comparative valuations, the court should require a high threshold of proof that the dissenting class is not going to be prejudiced by the cram down.[80]

Operation of the Singapore cross-class cram down

Section 70 of IRDA provides that a Court may approve a compromise or arrangement, and order that the compromise or arrangement be binding on the company and all classes of creditors meant to be bound by the compromise or arrangement where the requirements of section 70 are satisfied.[81]

These requirements are that:

- the scheme is approved by a majority in number, representing at least 75% of the value, of those present and voting at the meeting of at least one class of creditors;[82]
- the scheme is also approved by creditors comprising a majority in number, representing at least 75% of the value, of those present and voting at the meeting(s) of scheme creditors as a whole;[83] and
- the scheme is "fair and equitable" to each dissenting class of creditors and does not "discriminate unfairly" between two or more classes of creditors.[84]

The requirement at section 70(3) that the schemes be approved by a majority in number, representing at least 75% of the value, of those present and voting at the meeting(s) of scheme creditors as a whole, is puzzling. Whilst the ILRC seemed to consider this provided some degree of creditor protection, it is unclear why the level of satisfaction or dissatisfaction with the scheme in a consenting class should be relevant to whether a dissenting class is crammed down. In practice, this would appear to limit the quantum of

79 Insolvency Law Reform Committee (Singapore), *Final Report* (4 October 2013) [49].

80 Insolvency Law Reform Committee (Singapore), *Final Report* (4 October 2013) [53].

81 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(2).

82 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(1).

83 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(3).

84 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(3)(c).

claims (and number of creditors) that could be subject to the Singapore cross-class cram down.

Section 70(4) further provides that a compromise or an arrangement is not fair and equitable to a dissenting class unless:

- no creditor in the dissenting class receives, under the terms of the compromise or arrangement, an amount that is lower than what the creditor is estimated by the Court to receive in the most likely scenario if the compromise or arrangement does not become binding on the company and all classes of creditors meant to be bound by the compromise or arrangement; and
- either of the following applies:
  - where the creditors in the dissenting class are secured creditors, the terms of the compromise or arrangement —
    - must provide for each creditor in the dissenting class to receive deferred cash payments totalling the amount of the creditor's claim that is secured by the security held by the creditor, and preserve that security and the extent of that claim (whether or not the property subject to that security is to be retained by the company or transferred to another entity under the terms of the compromise or arrangement);
    - must provide that where the security held by any creditor in the dissenting class to secure the creditor's claim is to be realised by the company free of encumbrances, the creditor has a charge over the proceeds of the realisation to satisfy the creditor's claim that is secured by that security; or
    - must provide that each creditor in the dissenting class is entitled to realise the indubitable equivalent of the security held by the creditor in order to satisfy the creditor's claim that is secured by that security;
  - where the creditors in the dissenting class are unsecured creditors, the terms of the compromise or arrangement —
    - must provide for each creditor in that class to receive property of a value equal to the amount of the creditor's claim; or
    - must not provide for any creditor with a claim that is subordinate to the claim of a creditor in the dissenting class, or any member, to receive or retain any property of the company on account of the subordinate claim or the member's interest.

Section 70(4) of the IRDA incorporates parts of the "absolute priority rule" as provided for in section 1129(b) of the US Bankruptcy Code. In particular, section 70(4) requires that for a class of unsecured creditors to be crammed down, either such unsecured creditors must be paid in full, or the terms of the scheme must not provide for any creditor subordinate to the dissenting creditor to receive or retain any property of the company.[85]

However, unlike the cross-class cram down provisions in the US Bankruptcy Code (or under the UK restructuring plan), the Singapore provision does not provide for any ability to cram down shareholders (notwithstanding that shareholders are on the most junior

[85] *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(4); *Bankruptcy Code 1978*, 11 USC § 1129(b)(2)(B).

rung of the company's capital structure) as part of a creditors' scheme of arrangement. Given the inability to cram down shareholders, the inclusion of the absolute priority rule as part of the Singapore cross-class cram down regime is somewhat odd.[86]

(d) Singapore rescue financing

The Singapore Amending Act also incorporated a "debtor-in-possession" priority rescue financing regime into the scheme of arrangement process, drawing on the concepts contained within section 364 of the US Bankruptcy Code.

To access priority funding under section 67 of the IRDA, a company must have made an application to either obtain a moratorium order or convene a scheme of arrangement meeting. Upon seeking a moratorium or scheme meeting, the company may make an additional application to the court seeking priority treatment be bestowed on "rescue financing" obtained by the company.[87]

Rescue financing means any financing that is necessary: [88]

- for the survival of the company (or of the whole or any part of the undertaking of the company) as a going concern; or
- to achieve a more advantageous realisation of the assets of the company than on a winding up.

If this criteria is satisfied, the court may grant orders affecting the priority treatment of the rescue financing such that:[89]

- the debt be treated as if it was part of the costs and expenses of the winding up;
- the debt be given priority over preferential debts in the winding up of the company, if the company would not have been able to obtain the rescue financing from any person without such security;
- the debt be secured by a security interest on property of the company that is not otherwise subject to any security interest, or a subordinate security interest on property of the company that is subject to an existing security interest. This order may only be granted if the company would not have been able to obtain the rescue financing from any person without such security; or
- the debt be secured by a security interest on property of the company that is subject to an existing security interest, of the same priority as or a higher priority than the existing security interest. This order may only be granted if:
  - the company would not have been able to obtain the rescue financing from any person without such security; and
  - there is 'adequate protection' for the interests of the holder of the existing security interest.

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86 The position was even more problematic when the amendments were first introduced, as the original drafting of the absolute priority rule as pertaining to the cram down provision meant that even junior classes of creditors would in practice likely be unable to be crammed down. See discussion in Paul Apáthy and Emmanuel Chua, 'Singapore's new "supercharged" scheme of arrangement'(2017) 18(5) *Insolvency Law Bulletin* 98. Whilst this issue has been remedied (by way of the slightly adjusted wording in *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(4)(b)(ii)(B), it is still impossible to cram down members under the Singapore legislation. See a more detailed discussion of these issues in Paul Apáthy, Emmanuel Chua and Rowena White "Singapore's New "Omnibus" Insolvency, Restructuring and Dissolution Bill" *Law Gazette* (January 2019).

87 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 67.

88 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 67(9).

89 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 67(1).

The last of these tiers effectively allows the granting of what in the United States is referred to as a "priming lien" that ranks ahead of existing secured creditors. However, the availability of this order is constrained by the adequate protection requirement. There is adequate protection for existing security interests if:[90]

- the Court orders the company to make one or more cash payments to the security holder, the total amount of which is sufficient to compensate the holder for any decrease in the value of the holder's existing security interest;
- the Court orders the company to provide the holder with additional or replacement security of a value sufficient to compensate the holder for any decrease in the value of their existing security interest; or
- the Court grants any relief that will result in the realisation by the holder of the indubitable equivalent of the holder's existing security interest.

Whilst there have been a few rescue financing orders made in Singapore since this regime was introduced,[91] to our knowledge no orders have been made in respect of the grant of security ranking ahead of existing security. This is presumably because of the difficulty in practice of establishing that existing secured lenders would be adequately protected and given that the climate in Singapore remains pro-bank financiers.

Given the normal lack of statutory restrictions on Singapore companies that are subject to moratoriums granting security, it is actually not clear that there is any need for the court to make an order that the rescue financing be secured over assets that are unsecured (or that ranks behind existing security).[92] This is subject to any order of the Court preventing the company from granting new security without the approval of the Court.

(e) How have the Singapore reforms to creditors' schemes of arrangements operated in practice?

As part of preparing these submissions we have spoken to a number of restructuring and insolvency professionals who operate in the Singapore market.

They have expressed some concern as to how the Singapore regime has operated in practice, particularly in respect to the moratorium. They have commented that the moratorium has been relatively easy for companies to access, even where the companies have not had a scheme of arrangement that was well-developed or viable. They also noted that the courts in Singapore have given debtors "a long leash" such that moratorium orders have been granted and extended, in some cases for considerable periods and numerous times, where there is little evidence of any creditor support for a viable restructuring.

Indeed, concerns have been raised that the moratorium has been utilised as a method of excluding creditors from enforcing their rights, or participating in meaningful restructuring discussions. In addition, companies have frequently resisted providing significant financial information or updates to creditors during the moratorium process, leading in some cases to repeated court clashes between the company and its creditors, where the creditors

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90 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 67(6). These adequate protection requirements are based on the requirements to establish adequate protection under the *Bankruptcy Code 1978*, 11 USC § 364 (2021).

91 See, eg, *Re Design Studio Group Ltd and other matters* [2020] SGHC 148. The Court in that case granted a rescue financing order where newly input post-petition finances were used to pay off existing pre-petition debt such that the pre-petition debt is effectively "rolled up" into the super-priority post-petition debt. The Court clarified in that case that the super priority is not solely for new money financings.

92 It is also unclear the extent to which section 67 is able to override prohibitions on the grant of security: see discussion in Paul Apáthy and Emmanuel Chua, 'Singapore's new "supercharged" scheme of arrangement' (2017) 18(5) *Insolvency Law Bulletin* 98.

have made application for court orders requiring the company to provide the creditors with greater transparency.

Notable examples of this dynamic include in the high profile cases of the *Hyflux* and *Pacific Radiance* proposed schemes of arrangement. *Hyflux*, which first sought a six month moratorium in 2018, had judicial managers eventually appointed by the Court in November 2020, having failed to demonstrate progress towards a viable restructuring after being subject to a moratorium for 2.5 years with a total of 12 extensions being obtained over that period. During the time that *Hyflux* was protected from enforcement action, no scheme was proposed and the value of the company's assets deteriorated from at least SGD 300 million to between SGD 63 and 133 million.[93] In *Pacific Radiance's* case, a moratorium was obtained in June 2018. The company remains under a moratorium until at least 30 September 2021 with a restructuring proposal (which did not involve a scheme) being put before creditors in 2021.[94]

It appears that the introduction of the Moratoria Guidance in early 2021 may have been, in part, an attempt to address some of these issues and concerns, effectively placing greater scrutiny on the appropriateness of companies' access to moratorium orders.

Noting these issues, professionals we have spoken to have had difficulty identifying examples of successful use of the "Singapore Model" other than in respect of the pre-packaged schemes of arrangement (see discussion at section 8.8 below), which the professionals considered generally worked well.[95]

These experiences give rise to a degree of caution as to adopting the "Singapore model" of broad moratoriums in respect of schemes of arrangement.

Our conclusions arising from the Singapore experience are that appropriate transparency and oversight must be the "price" of a debtor-in-possession moratorium,[96] and that there must be clear temporal limitations on the moratorium (as there are in the case of regimes in other jurisdictions such as the UK, India and Indonesia).

5.4 United Kingdom

(a) Creditors' schemes of arrangement in the UK

Schemes of arrangement were first enacted in the UK (in a form that is recognisable today) by way of section°2 of the *Joint Stock Companies Arrangement 1870* (UK). However, the history of the scheme of arrangement legislation in the UK can be traced back even further to sections 136 and 137 and sections 159 and 160 of the *Companies*

93 Ashley Bell, 'Hyflux's 'better-than-nothing' restructuring plan emerges amid value destructive court-supervised process', *Debtwire* (Article, 7 January 2020) <https://www.debtwire.com/intelligence/view/prime-2964090>; Ashley Bell, 'Hyflux's arrogance sends the group into judicial management: key takeaways and questions as an appeal looms', *Debtwire* (Article, 23 November 2020) <https://www.debtwire.com/intelligence/view/intelcms-x6mq9v>.

94 Pacific Radiance Ltd, 'Update on Restructuring — Principal Terms of Debt Restructuring' (SGX Announcement, 30 June 2021) <https://links.sgx.com/1.0.0/corporate-announcements/M45RG43NK8AAVCWR/c84c8e2308c635b959cca69adbcf91615137f1032bc04bbaecb6cfd397f619e3>; Pacific Radiance Ltd, 'Outcome of Applications for Extension of Moratoria' (SGX Announcement, 13 July 2021) <https://links.sgx.com/1.0.0/corporate-announcements/I9AVXN7EX68NP7JI/2215212053b12b119cec35a0b130fe48c9bace31769347fc6f8646f2e126bb18>.

95 We note that these discussions occurred prior to the delivery of the decision in *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209, the first written decision in Singapore in connection with a pre-packaged scheme of arrangement (and in which the court refused to sanction the scheme). It is possible that this decision has impacted views on the pre-packaged scheme process.

We note that one professional also considered the ability to extend the moratorium to related companies in a group restructure to be a successful element of the Singapore Model.

96 Some professionals in Singapore also added the use of creditors' committees may be beneficial.

Act 1862 (UK). Since then they been incorporated into successive companies legislation, most recently Part 26 of the UK Companies Act.

In terms of their use in restructurings since the 2000s:

> The existing part 26 scheme of arrangement has been praised for being relatively "light touch" for large companies compared to other international restructuring procedures, and has proven popular for situations where the majority of a company's financial creditors agree to a restructuring plan, despite the lack of a moratorium attached to the procedure.[97]

(b) Recent UK restructuring and insolvency law reforms

In 2020, the UK Parliament enacted the CIGA, which came into effect on 25 June 2020. The CIGA was passed rapidly to address the effects of COVID-19, containing both COVID-19 temporary relief measures as well as permanent law changes that had been under some consideration by the Government of the United Kingdom (**UK Government**) for a longer period.

The most significant changes introduced by the CIGA were two new regimes:

- **the Part A1 moratorium**: a "stand-alone" debtor-in-possession style moratorium which was made available to companies seeking time to consider their options for addressing their financial difficulties; and
- **the Part 26A restructuring plan**: a new procedure under Part 26A of the UK Companies Act, commonly referred to as the "restructuring plan" (despite this label not being used in the legislation). The restructuring plan is largely based on the existing UK creditors' scheme of arrangement procedure under Part 26 of the UK Companies Act, but with several key changes, including in particular that:
  - it is available only to companies experiencing or likely to experience financial distress;
  - it includes a cross-class cram down mechanism;[98] and
  - it has modified voting threshold requirements.

The moratorium and restructuring plan reforms were first proposed in The Insolvency Service's *Review of the Corporate Insolvency Framework* in 2016 (**2016 Review**).[99] The review was inspired by the Word Bank's "Doing Business" ranking, which placed the UK 6th overall, and 13th on the World Bank's "Resolving Insolvency" ranking.[100]

(c) No specific moratorium provision for schemes of arrangement in the UK

There is no statutory equivalent to the stay order available section 411(16) under the Corporations Act (or the enhanced moratorium available under section 64 of the IRDA) available in respect of UK schemes of arrangement or restructuring plans.

However, the English Courts have exercised their case management discretions in certain cases to make an order pursuant to rule 3.1(2)(f) of the *Civil Procedure Rules* (UK) which allows the Courts to "stay the whole or part of any proceedings or judgment

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97 Sarah Paterson, 'Reflections on English Schemes of Arrangement in Distress and Suggestions for Reform' (2018) 15(3) *European Company and Financial Law Review* 472, 477.

98 *Companies Act 2006* (UK) ss 901A, 901G.

99 The Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform* (Consultation, 25 May 2016) [9.32].

100 Robin Dicker QC and Adam Al-Attar, 'Cross-Class Cram Downs Under Part 26A Companies Act 2006, Corporate Insolvency and Governance Act 2020, Schedule 9' [2020] *South Square Digest* 34.

either generally or until a specified date or event".[101] In practice, the orders made by the Courts in such circumstances appear reasonably similar to the scope of those made under section 411(16) of the Corporations Act.[102]

The introduction of a stand-alone statutory moratorium which would be available to companies pursuing the scheme of arrangement procedure was considered in a 2018 consultation on Insolvency and Corporate Governance.[103] The UK Government's response to consultation submissions was generally supportive of the introduction of a moratorium which would cover, among other things, the creditors' scheme of arrangement procedure:

> [5.9] The Government has considered the responses to the consultation carefully and has concluded, on balance, it agrees with those respondents who supported the introduction of a moratorium. The introduction of a moratorium, modelled on the same parameters as the administration moratorium, will give financially distressed but viable companies the time to consider options for addressing financial and economic problems. This will, in many cases, facilitate the rehabilitation and rescue of companies in the longer term, thereby preserving value and safeguarding jobs.
>
> [5.10] A key objective of the Government's proposals is to reduce the costs and risks of restructuring. Stakeholders have criticised the existing Schedule A1 company voluntary arrangement (CVA) moratorium for being restricted to small companies and being burdensome in nature for the insolvency practitioner acting as nominee, being both bureaucratic and carrying a risk of personal liability. Lifting size restrictions to allow medium and large-sized companies to use the Schedule A1 moratorium may help in theory. However, views on the shortcomings of this moratorium suggest that, in practice, it would rarely be used, as is already the case for small companies for whom it is already available.
>
> [5.11] While the Court has been willing to stay enforcement proceedings while a debtor attempts to finalise a scheme of arrangement (see the Court's decision in *Re Bluecrest Mercantile BV*), this has been exercised where negotiations were at an advanced stage and clearly represented a workaround to overcome the current absence of a statutory moratorium. The Government is aware of examples of schemes of arrangement being used for the purpose of creating a moratorium, as an interim measure before a more substantive restructuring can be effected via a further scheme of arrangement.
>
> [5.12] Further efforts to find workarounds to the current absence of a statutory moratorium can be evidenced by the attempted use of repeated notices of intention to appoint an administrator in order to provide breathing space by benefitting from the interim moratorium provisions while a number of possible rescue options are explored. However, the filing of such notices without a settled intention to appoint an administrator has recently been held by the court to be invalid.
>
> [5.13] The introduction of a moratorium with a clearly defined and streamlined entry process should reduce the cost of restructuring and will be accessible to companies of any size. This will aid company rescue by giving companies time and space to consider available options when it is most needed.[104]

The CIGA introduced the new stand-alone moratorium process by way of a new Part A1 of the UK Insolvency Act, as described further in the following section. Although the moratorium was intended to aid company rescue and be accessible to companies of any

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101 See *Bluecrest Mercantile BV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm).

102 It seems, however, that the merits of the proposed scheme (ie how likely it is that it will be approved) may be more significant for the English courts. See *Bluecrest Mercantile BV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm), [38]–[40]

103 Department for Business, Energy & Industrial Strategy, *Insolvency and Corporate Governance: Government response* (Response, 26 August 2018).

104 Department for Business, Energy & Industrial Strategy, *Insolvency and Corporate Governance: Government response* (Response, 26 August 2018) 43.

size, for the reasons described below, in practice there has been relatively little take up of the Part A1 Moratorium procedure.

(d) UK Part A1 Moratorium

The Part A1 Moratorium is a new voluntary debtor-in-possession procedure under the UK Insolvency Act. The explanatory memorandum in respect of the CIGA notes that the Part A1 Moratorium was intended to be designed to give eligible companies the "breathing space" required to allow them to explore their rescue and restructuring options free from creditor action.[105] The aim of the moratorium is to facilitate a rescue of the relevant company, which could be via a company voluntary arrangement (**CVA**), a restructuring plan (see section 5.4(g) below) or an injection of new funds in a manner which will result in a better, more efficient rescue plan that benefits all of the company's stakeholders.[106] The moratorium is designed to be streamlined, cost-effective and to impose a minimal administrative burden.[107]

In the 2016 Review, the UK Government explained that the moratorium was being considered to implement the World Bank Principle C5.3 that:

> a stay of actions by secured creditors should be imposed … in reorganisation proceedings where the collateral is needed for the reorganisation. The stay should be of limited, specific duration, strike a proper balance between creditor protection and insolvency proceeding objectives and provide for relief from the stay by application to the Court.[108]

The Part A1 Moratorium provides for a moratorium to start in respect of an eligible company where certain specified documents are filed with the Court.[109] Upon commencement of the moratorium the specified "monitor" is appointed to that company.[110]

The moratorium continues until the end of an "initial period" of 20 business days, which may be extended by the directors for up to an aggregate period of 40 days unless it comes to an end earlier in accordance with the provisions of Part A1. There are provisions for the directors of the company to further extend the moratorium with[111] or without[112] creditor consent, or for the court to order an extension on the application of the directors,[113] or in the course of other proceedings.[114] A moratorium will come to an end if the company enters into a scheme of arrangement, restructuring plan or an insolvency procedure.[115]

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105 Explanatory Notes, Corporate Insolvency and Governance Act 2020 (UK) [4], [79].

106 Explanatory Notes, Corporate Insolvency and Governance Act 2020 (UK) [5].

107 Explanatory Notes, Corporate Insolvency and Governance Act 2020 (UK) [6].

108 The Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform* (Consultation, 25 May 2016) [7.1].

109 *Insolvency Act 1986* (UK) ss A3, A6, A7. If the company is subject to an outstanding winding-up petition, or an overseas company, then the moratorium may only be commenced by an order of the Court: *Insolvency Act 1986* (UK) ss A3, A4, A5.

110 *Insolvency Act 1986* (UK) s A7.

111 *Insolvency Act 1986* (UK) ss A11, A12.

112 *Insolvency Act 1986* (UK) s A10.

113 *Insolvency Act 1986* (UK) s A13.

114 *Insolvency Act 1986* (UK) s A15. Notably this includes in connection with an application for a scheme of arrangement or restructuring plan in respect of the company.

115 *Insolvency Act 1986* (UK) s A16.

There are a number of exemptions that limit or exclude the application of the moratorium for certain types of companies. These include, by way of example:

- insurance companies,[116] banks,[117] electronic money institutions[118] (ie providers of electronic funds services), investment banks and investment firms,[119] and public private partnership project companies;[120] and
- companies where at the time the company files for a moratorium it is a party to an agreement which is or forms part of a capital market agreement; a party has incurred, or when the agreement was entered into was expected to incur, a debt of at least GBP10m under the arrangement; and the arrangement involves the issue of a capital market investment.[121]

During the moratorium period, a company remains under the directors' control and may continue to trade (subject to the restrictions outlined below). The Part A1 Moratorium is a debtor-in-possession procedure: the directors retain their powers and the monitor does not have any direct control over the business or act as the company's agent during the Part A1 Moratorium. [122] Instead, the monitor performs an oversight role including: assessing eligibility to rely on the moratorium, monitoring the probability of rescue, and sanctioning asset disposals outside of the ordinary course of business (as outlined below).[123]

The company is subject to a number of restrictions on its activities during the moratorium period, including the following:

- the company may not obtain credit (of GBP500 or more) from a person unless the person has been informed that a moratorium is in force in relation to the company;[124]
- the company cannot grant security over its property unless the monitor consents;[125]
- the company cannot make payments in respect of pre-moratorium debts[126] (exceeding the greater of GBP5,000 or 1% of all its debts) unless the monitor consents or the Court orders otherwise;[127] or

116 *Insolvency Act 1986* (UK) sch ZA1 para 3.

117 *Insolvency Act 1986* (UK) sch ZA1 para 4.

118 *Insolvency Act 1986* (UK) sch ZA1 para 5.

119 *Insolvency Act 1986* (UK) sch ZA1 para 6.

120 *Insolvency Act 1986* (UK) sch ZA1 para 15.

121 *Insolvency Act 1986* (UK) sch ZA1 para 13.

122 *Insolvency Act 1986* (UK) ss A34, A35.

123 See generally Glen Davis QC, 'The Role of the Monitor in a Rescue Moratorium' [2020] (June) *South Square Digest*.

124 *Insolvency Act 1986* (UK) s A25.

125 *Insolvency Act 1986* (UK) s A26.

126 A "pre-moratorium debt" is to debts that have fallen due before the moratorium, or that fall due during the moratorium, except in so far as they consist of amounts payable in respect of— (a) the monitor's remuneration or expenses, (b) goods or services supplied during the moratorium, (c) rent in respect of a period during the moratorium, (d) wages or salary arising under a contract of employment, (e) redundancy payments, or (f) debts or other liabilities arising under a contract or other instrument involving financial services.

127 *Insolvency Act 1986* (UK) s A28.

- the company cannot dispose of property other than in the ordinary course of business unless the monitor consents or the Court orders otherwise.[128]

During the moratorium period (in broad terms, and subject to certain exceptions):

- no winding up or liquidation may be commenced except at the initiation or recommendation of the directors;
- no administration may be commenced except by the directors;
- no administrative receiver of the company may be appointed;
- a landlord may not re-enter the premises of the company;
- no steps may be taken to enforce security over the company's property;
- no steps may be taken to repossess goods in the company's possession under hire purchase agreements; or
- no legal process may be instituted or continued against the company or its property.

An eligible company can seek a Part A1 Moratorium by simply filing the required documents with the Court.[129] The High Court of England and Wales has limited oversight regarding the Part A1 Moratorium; however, there are several safeguards to ensure the process is not exploited, including:

- the requirement for the monitor to sign a declaration at the commencement of the Part A1 Moratorium that the moratorium is reasonably likely to lead to a rescue of the company;[130]
- the restriction on the company granting new security or disposing of assets outside the ordinary course of business without the monitor's consent;[131]
- the monitor's obligation to bring the moratorium to an end if the moratorium is no longer likely to result in the rescue of the company as a going concern, or if the monitor forms a view that the company is unable to pay debts incurred during the moratorium, or debts to which no payment holiday applies;[132]
- a limited duration (the Part A1 Moratorium is for a period of 20 business days with the possibility of extension);[133] and
- the exclusion of finance debt and certain other debts from the moratorium, which must therefore be paid for the moratorium to continue.[134]

(e) Priorities of moratorium debt, pre-moratorium debt, and priority pre-moratorium debt

The Part A1 Moratorium divides the company's debts into three categories:

- **Pre-moratorium debts for which the company has a "payment holiday"**: these are debts and liabilities that a company becomes subject to before the moratorium, or becomes subject to during the moratorium, where the obligation

128 *Insolvency Act 1986* (UK) s A29.

129 *Insolvency Act 1986* (UK) ss A3, A6.

130 *Insolvency Act 1986* (UK) s A6.

131 *Insolvency Act 1986* (UK) ss A25–A26.

132 *Insolvency Act 1986* (UK) s A38.

133 *Insolvency Act 1986* (UK) s A9.

134 *Insolvency Act 1986* (UK) s 13ED.

was incurred before the moratorium (subject to some conditions for liabilities in tort and delict).[135] These pre-moratorium debts do not need to be paid while the moratorium is in place.

- **Pre-moratorium debts for which the company does not have a "payment holiday"**: these include, among other things, goods and services supplied during the moratorium, wages, salaries, redundancy payments, rent and debts or other liabilities arising under a contract or instrument involving financial services, which would include instruments such as secured and unsecured loans and listed securities such as notes or bonds.[136] These debts are not subject to the moratorium, giving them effective priority over the pre-moratorium debts for which the company has a payment holiday.
- **Moratorium debts**: these are debts or liabilities that a company becomes subject to during the moratorium unless the obligation was incurred before the moratorium, or may become subject to after the moratorium where the obligation was incurred during the moratorium (subject to some conditions for liabilities in tort and delict).[137]

A monitor must bring a moratorium to an end when they think that a company will not be able to pay any moratorium debts or pre-moratorium debts for which the company does not have a payment holiday when they fall due.[138]

Where insolvency proceedings for the winding up of a company begin within 12 weeks of a moratorium ending, there is a super-priority of the following debts to all other claims in the winding up:

- any prescribed fees or expenses of the official receiver acting in any capacity in relation to the company;
- moratorium debts (as described above) and priority pre-moratorium debts.

Priority pre-moratorium debts are a slightly narrower category of pre-moratorium debts without a payment holiday, being any debts payable in respect of monitor fees and expenses, goods or services supplied to the company during the moratorium, wages owed to employees for a period before or during the moratorium, liabilities for redundancy payments arising before or during the moratorium, and contracted financial services arising before or during the moratorium (except to the extent they have been accelerated).

Where there are insufficient assets to meet the moratorium debts and priority pre-moratorium debts in full, priority between those debts is as follows:

- amounts payable in respect of goods or services supplied during the moratorium under a contract where, but for sections 233B(3) or (4) of the UK Insolvency Act, the supplier would not have had to make that supply;
- wages or salary arising under a contract of employment;
- other debts or other liabilities apart from the monitor's remuneration or expenses; and
- the monitor's remuneration or expenses.[139]

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135 *Insolvency Act 1986* (UK) s A53(1).

136 *Insolvency Act 1986* (UK) s A18(3).

137 *Insolvency Act 1986* (UK) s A53(2)

138 *Insolvency Act 1986* (UK) s A38(1).

139 *Corporate Insolvency and Governance Act 2020* (UK) sch 4 para 42

(f) Reception to the Part A1 Moratorium in the UK

To date, there has been a muted response to the introduction of the Part A1 Moratorium. Between 26 June 2020 and 31 July 2021, only thirteen companies obtained a Part A1 Moratorium according to Companies House records.[140]

The response to the introduction of the Part A1 Moratorium can be partially explained by the context in which it was introduced — in Q4 2020 the total number of company insolvencies dropped to their lowest levels since 1989 in part due to the COVID-related restrictions on winding up petitions that have been in place since the moratorium was introduced.[141] These restrictions reduce the need for protection against a company's creditors and therefore diminish the utility of a moratorium.

Though the lack of adoption of the Part A1 Moratorium is explained somewhat by extraneous factors, the moratorium also has a number of features that have been criticised by commentators (which may be explained to some extent by the speed at which the CIGA was passed). There are several possible reasons put forward by commentators and practitioners as to why the moratorium has not been utilised in great numbers, including notably:

- company insolvencies have remained lower than pre-pandemic levels;[142]
- the protections given to finance creditors can, in practice, limit the usefulness of the moratorium for large companies with a sophisticated finance structure where rescue may depend upon being able to delay the payment of and ultimately compromise the finance debt, which is not subject to the moratorium.[143] The exemption from the moratorium arguably extends to supply contracts so long as there is a credit element to the contract.[144] Given that financial debts and liabilities are classed as pre-moratorium debts without a payment holiday, and it is a condition of the moratorium continuing that such debts continue to be paid, the moratorium of itself does not afford companies the breathing room to negotiate a restructuring with their financial creditors if there are imminent interest or principal payments due that they cannot meet.[145]
- a company is ineligible for the moratorium if, on the filing date, it is a party to a capital markets arrangement in an amount over GBP10 million.[146] There has been a marked trend in the last decade or so for UK and European companies to access the capital markets, making those companies ineligible for the

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140 The Insolvency Service, 'Monthly Insolvency Statistics July 2021', *Business and industry* (Web Page, July 2021) <https://www.gov.uk/government/statistics/monthly-insolvency-statistics-july-2021>.

141 Ashurst, 'Corporate Insolvency and Governance Act 2020: One year on', *RSSG Thought of the Month* (Blog Post, 14 June 2021) <https://www.ashurst.com/en/news-and-insights/insights/corporate-insolvency-and-governance-act-2021---one-year-on/>.

142 The Insolvency Service, 'Commentary – Monthly Insolvency Statistics July 2021', *Business and industry* (Web Page, 17 August 2021) <https://www.gov.uk/government/statistics/monthly-insolvency-statistics-july-2021/commentary-monthly-insolvency-statistics-july-2021>; Ashurst, 'Corporate Insolvency and Governance Act 2020: One year on', *RSSG Thought of the Month* (Blog Post, 14 June 2021) <https://www.ashurst.com/en/news-and-insights/insights/corporate-insolvency-and-governance-act-2021---one-year-on/>.

143 Ashurst, 'Corporate Insolvency and Governance Act: The Moratorium', *RSSG Update* (Blog Post, 26 June 2020) <https://www.ashurst.com/en/news-and-insights/legal-updates/ciga---the-moratorium/>.

144 Herbert Smith Freehills, 'Governance: Corporate Insolvency and governance Bill: Impact on Supply Chains and their Customers (UK)', *Latest Thinking* (Web Page, 9 June 2020) <https://www.herbertsmithfreehills.com/latest-thinking/governance-corporate-insolvency-and-governance-bill-impact-on-supply-chains-and>.

145 DLA Piper, 'UK Corporate Insolvency And Governance Act: Moratorium', *Publications* (Blog Post, 1 April 2021) <https://www.dlapiper.com/es/spain/insights/publications/2020/09/uk-corporate-insolvency-and-governance-bill/>.

146 *Insolvency Act 1986* (UK) sch ZA1 para 13

moratorium on the basis that they are a party to a capital market arrangement in an amount over GBP10 million.[147]

- during a moratorium, the monitor must monitor the company's affairs for the purpose of forming a view as to whether it remains likely that the moratorium will result in the rescue of the company as a going concern.[148] The requirement that a rescue of *the company* as a going concern must be likely, rather than a rescue of *the business*, means that the moratorium cannot be used to stabilise a company's position in preparation for a business sale, whether through a pre-pack administration or otherwise, where the relevant "company" is often left behind to be wound up while the business continues in the new structure as a going concern. Concerns were raised around both of these points in the House of Lords debates on the legislation, with suggestions made that the moratorium should be available where it could, rather than would, result in rescue, and where the business could be rescued but the company could not. Neither of these suggested changes were accepted;[149]
- the availability and growing usage of "light touch" administrations, whereby, within the framework of the UK administration, an administrator delegates their power to the directors to continue to exercise key management powers.[150] The administrator continues to provide oversight of the restructure while the company enjoys the benefit of the statutory moratorium in the hope of being rescued as a going concern.[151] By way of example, in July 2017, Paragon Offshore Plc entered into a voluntary administration that included a management agreement that allowed for a newly formed subsidiary to manage the larger groups' assets whilst Paragon Offshore Plc was under administration.[152] More recently, in 2020, the administrators of Debenhams Retail Limited consented to management continuing to exercise their functions, with the aim of resuming trading from its stores when pandemic lockdowns were lifted;[153] and
- moratorium debts and priority pre-moratorium debts (monitor fees and expenses, debts for goods or services supplied to the company during the moratorium and debts owed to employees)[154] enjoy super-priority in a subsequent insolvency proceeding that occurs within 12 weeks of the moratorium.[155] This includes liabilities under contracts for financial services which fell due either before the moratorium or during the moratorium (but did not fall due to an acceleration of the debt during the moratorium).[156] Such debt, even if originally unsecured, will enjoy priority over secured finance debt and the

147 BNP Paribas, 'Capital markets: why they matter for the UK economy', *Market Trends* (Blog Post, 18 June 2020) <https://cib.bnpparibas/capital-markets-why-they-matter-for-the-uk-economy/>.

148 *Insolvency Act 1986* (UK) s A35.

149 DLA Piper, 'UK Corporate Insolvency And Governance Act: Moratorium', *Publications* (Blog Post, 1 April 2021) <https://www.dlapiper.com/es/spain/insights/publications/2020/09/uk-corporate-insolvency-and-governance-bill/>.

150 *Insolvency Act 1986* (UK) sch B1 para 64.

151 Morgan Lewis, 'Covid-19: Light-Touch Administration – What Is It And How Does It Work?', *Lawflash* (Blog Post, 24 April 2020) <https://www.morganlewis.com/pubs/2020/04/covid-19-light-touch-administration-what-is-it-and-how-does-it-work-cv19-lf>.

152 *Re Paragon Offshore Plc* [2020] EWHC 1925 (Ch), [22].

153 *Re Debenhams Retail Ltd (In Administration)* [2020] EWHC 921 (Ch), [20]; *Re Debenhams Retail Ltd (In Administration)* [2020] EWCA Civ 600, [6].

154 *Insolvency Act 1986* (UK) s 174A(3).

155 *Insolvency Act 1986* (UK) s 174A; *Companies Act 2006* (UK) s 901H.

156 *Insolvency Act 1986* (UK) s 174A(3)(c).

fees incurred in the subsequent administration process. This may affect the value of security, and may deter insolvency professionals from accepting appointments over companies that have previously been in a moratorium process.[157] This may also give rise to concerns for directors from a director's duties perspective, as electing to commence a Part A1 Moratorium may result in a change of creditor priorities, benefiting some creditors at the expense of others.

(g) UK restructuring plan

As discussed above, the CIGA also introduced the "restructuring plan" via a new Part 26A of the UK Companies Act.

Although restructuring plans are a separate procedure, the drafting and mechanics are largely based on and comparable to the existing scheme of arrangement process under Part 26 of the UK Companies Act. These similarities are deliberate, as the UK Government has indicated that courts should look to existing case law regarding schemes of arrangement for insights into how to assess restructuring plans.[158] A restructuring plan may extend to both creditors and members of the company.

There are four principal distinctions between a scheme of arrangement and the new restructuring plan:

- to be eligible to pursue a restructuring plan, the company must have encountered, or be likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern;[159]
- the restructuring plan abolishes the "head count test";
- the restructuring plan contains a cross-class cram down mechanic granting the ability to bind classes of non-consenting creditors and shareholders to the plan; and
- suppliers of goods and services are unable to exercise termination rights which would have arisen due to insolvency (ipso facto clauses) without the consent of the Court or the company itself.[160]

The key components of the restructuring plan compared to the existing scheme of arrangement procedure are illustrated by the table below:

	UK scheme of arrangement	UK restructuring plan
Financial difficulties eligibility test	No	Yes
Stay on enforcement action	May seek court order pursuant to the Court's inherent jurisdiction	May seek court order pursuant to the Court's inherent jurisdiction
Ipso facto protection	No	Yes
Separate classes	Yes	Yes
Intra-class cram down	Yes	Yes

157 *Insolvency Act 1986* (UK) s 174A, sch B1; John Whiteoak et al, 'Wasted Breath? Insolvency Reforms in Response to COVID-19' (2020) 17(4) *International Corporate Rescue* 278, 282.

158 Explanatory Notes, Corporate Insolvency and Governance Act 2020 (UK) [16].

159 *Companies Act 2006* (UK) s 901A. The compromise or arrangement contained in the plan must be to eliminate, reduce or prevent, or mitigate the effect of, any of the financial difficulties affecting the company.

160 *Insolvency Act 1986* (UK) s 233B.

Cross-class cram down	No	Yes
Support required for class approval	75% by value 50% by number	75% by value
Basis for jurisdiction	Sufficient connection	Sufficient connection
Priority financing regime?	No	No

Cross-class cram down under the restructuring plan

Under section 901G of the UK Companies Act, a restructuring plan may be approved by the Court despite the dissent of one or more dissenting classes, where two conditions are satisfied:[161]

- **Condition A**: the court is satisfied that, if the compromise or arrangement were to be sanctioned, none of the members of the dissenting class would be any worse off than they would be in the event of the "relevant alternative";[162] and
- **Condition B**: the compromise or arrangement has been agreed by a number representing 75% in value of a class of creditors or (as the case may be) of members, present and voting either in person or by proxy at the meeting, who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative.[163]

The "relevant alternative" is the circumstance that the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned.[164]

Condition A

In *Virgin Active*, the Court said:

> The "no worse off" test can be approached, first, by identifying what would be most likely to occur in relation to the Plan Companies if the Plans were not sanctioned; second, determining what would be the outcome or consequences of that for the members of the dissenting classes (primarily, but not exclusively in terms of their anticipated returns on their claims); and third, comparing that outcome and those consequences with the outcome and consequences for the members of the dissenting classes if the Plans are sanctioned.
>
> It is important to appreciate that under the first stage of this approach, the Court is not required to satisfy itself that a particular alternative would definitely occur. Nor is the Court required to conclude that it is more likely than not that a particular alternative outcome would occur. The critical words in the section are what is "most likely" to occur. Thus, if there were three possible alternatives, the court is required only to select the one that is more likely to occur than the other two.
>
> Having identified the relevant alternative scenario, the Court is also required to identify its consequences for the members of the dissenting classes. This exercise is inherently uncertain because it involves the Court in considering a hypothetical counterfactual

161 *Companies Act 2006* (UK) s 901G(2).

162 *Companies Act 2006* (UK) s 901G(3).

163 *Companies Act 2006* (UK) s 901G(5).

164 *Companies Act 2006* (UK) s 901G(4).

which may be subject to contingencies and which will, inevitably, be based upon assumptions which are themselves uncertain. It is, however, a familiar exercise.[165]

The Court will have to determine the relevant alternative based on the evidence presented to it, and this will be a highly fact specific exercise.[166]

While the initial restructuring plans to be proposed did not seek to effect cross-class cram downs,[167] more recently this has been considered in *DeepOcean*,[168] *Virgin Active*[169] and *Hurricane Energy Plc*.[170] In those cases, the Court has held that in relation to Condition A:

- Condition A involves three steps: first, identifying what would be most likely to occur if the proposed restructuring plan were not sanctioned; second, determining the consequences of that relevant alternative scenario for creditors and shareholders; and third, comparing those consequences with the consequences if the restructuring plan is sanctioned;[171]
- identifying what would be the "relevant alternative" is similar to the exercise of identifying the appropriate comparator for class purposes in the context of a Part 26 scheme of arrangement[172] and the exercise of applying a "vertical" comparison for the purposes of an unfair prejudice challenge to a company voluntary arrangement;[173]
- it is not necessary to determine that a particular alternative would certainly occur or is even probable, merely that it is the one most likely to occur;[174]
- whether the class members would be "any worse off" begins with a comparison of the likely dividend or discount to par value in the "relevant alternative", but also includes "all incidents of the liability to the creditor concerned", including timing and the security of any covenant to pay;[175]
- the "relevant alternative" is to be considered at the time court approval is sought, not a hindsight consideration of what might have occurred if the plan companies had acted differently;[176] and
- the utility of Part 26A restructuring plans should not be undermined by lengthy valuation disputes, and there is no absolute obligation to undertake a market-testing process prior to launching a restructuring plan. A "desktop valuation" method could be used in certain circumstances to value the company for the

165 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), [106]–[108].

166 Mark Lawford, Andrew J Wilkinson and Matt Bendon, 'The New Restructuring Plan – In Depth', *European Restructuring Watch* (Web Page, 19 June 2020) <https://eurorestructuring.weil.com/reform-proposals-and-implementations/the-new-restructuring-plan-in-depth/>; Department for Business, Energy & Industrial Strategy, *Insolvency and Corporate Governance: Government response* (Response, 26 August 2018) [5.175].

167 See, eg, *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2376 (Ch), the first restructuring plan to come before the courts under Part 26A. All classes of Plan Creditors voted in favour of the proposed plan, and no cross-class cram down was required. The second Part 26A restructuring, *Re PizzaExpress Financing 2 Plc* [2020] EWHC 2873 (Ch), also featured unanimous support from the plan classes.

168 *Re DeepOcean I UK Limited* [2021] EWHC 138 (Ch).

169 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch).

170 *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch).

171 *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch), [36].

172 *Re DeepOcean I UK Limited* [2021] EWHC 138 (Ch), [29].

173 *Re DeepOcean I UK Limited* [2021] EWHC 138 (Ch), [30].

174 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), [107].

175 *Re DeepOcean I UK Limited* [2021] EWHC 138 (Ch), [35].

176 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), [115].

purposes of Condition A,[177] particularly where there are insufficient funds to undertake a market testing process[178] or market conditions are depressed.[179]

Hurricane Energy involved the first restructuring plan where the English court declined to approve the plan. In that case, Zacaroli J found that on the facts of that case, the company would most likely continue trading profitably in the short to medium term, and the rejected that the propounded "relevant alternative" of a controlled wind-down was unlikely to occur.[180] Another hypothetical alternative put forward by the restructuring plan proponents was an insolvent liquidation, but the judge held that this would only occur if the company engaged in costly alternative investment strategies.[181] For that reason, the "relevant alternative" was the company carrying on trading for at least another year, in which case the dissenting classes would be better off than under the proposed restructuring plan.[182] For this reason, Condition A was not met.

The 2018 *Review of Insolvency and Corporate Governance* explored employing a test which would compare the outcome for a class of creditors to the "minimum liquidation value test", but this was rejected in favour of the more flexible "relevant alternative" test.[183] When the restructuring plan reforms were first announced in the 2016 Review the restructuring plan included an absolute priority rule similar to the rule applied in Chapter 11 of the US Bankruptcy Code (**Chapter 11**), which would require amounts owed to a dissenting class of creditors to be satisfied in full before a more junior class of creditors could receive any distribution or keep any economic interest under the restructuring plan. This was excluded from the CIGA, as explained in the 2018 *Review of Insolvency and Corporate Governance* at [5.164]–[5.165]:

> The Government wants to inject flexibility into the APR, given the criticisms of US approach. The ability to act flexibly and pragmatically are not just desirable features in a restructuring procedure, but essential ones if the framework is to facilitate business rescue. The Government intends to permit the court to confirm a restructuring plan even if it does not comply with this rule where noncompliance is:
>
> - necessary to achieve the aims of the restructuring; and
> - just and equitable in the circumstances.
>
> This two-stage test for permitting non-compliance creates a high threshold. The basic principle that a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution will, in most cases, be followed. But there is sufficient flexibility to allow departure from it (with the court's sanction), where the departure is vital to agreeing an effective and workable restructuring plan. This will provide adequate protection for creditors while also achieving the best outcome for stakeholders as a whole.

Condition B

Condition B is that a restructuring plan must be approved by a class of creditors with a "genuine economic interest" in the relevant alternative. This will be satisfied by analysing the return that a class of creditors who have voted in favour of the restructuring plan would achieve in the relevant alternative.

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177 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), [138]–[143].

178 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), [144].

179 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), [145]–[149].

180 *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch), [54]–[60].

181 *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch), [65]–[68].

182 *Re Hurricane Energy Plc* [2021] EWHC 1759 (Ch), [125]–[128].

183 Department for Business, Energy & Industrial Strategy, I*nsolvency and Corporate Governance: Government response* (Response, 26 August 2018) [5.169]–[5.176].

(h) Reception to the restructuring plan in the UK

Since the passage of the CIGA, there have been several notable restructuring plans sanctioned by the Court, including in respect of the restructuring plans of: [184]

- Virgin Atlantic Airways;
- Pizza Express;
- DeepOcean;
- Gategroup;
- Virgin Active;
- Smile Telecom; and
- Amicus Finance.

While earlier restructuring plans such as Virgin Atlantic and Pizza Express in large part could have been pursued via Part 26 creditors' schemes of arrangement with little practical differences, in more recent restructuring plans such as Virgin Active and DeepOcean, companies have begun making use of the cross-class cram down powers.

- In *Virgin Active*,[185] the UK gym chain Virgin Active sought to reach a compromise with its lenders and landlords in order to address the liquidity crises created by the COVID-19 lockdowns. As part of a restructuring plan, the creditors of three companies in the Virgin Active Group were offered the following compromises:

  (1) **Senior lenders**: the group's £200 million senior facilities agreement would be amended to relax covenants and extend the maturity date;

  (2) **Class A & B landlords** (essential landlords): the group's essential leases would be afforded the option to either accept payment in arrears or determine their leases for a return slightly higher than would be received in an administration;

  (3) **Class C landlords**: landlords were offered rent reductions and release of rent arrears; and

  (4) **Class D and E landlords**: landlords provided with the right to determine leases in exchange for a slight increase in return in comparison to administration.

  Impaired landlords (Class C, D and E landlords) and general unsecured creditors were crammed down by two classes of creditors: the companies' secured lenders (whose debt maturities were extended as part of the plan) and critical landlords via three inter-conditional restructuring plans, which each contained seven creditor classes for voting purposes.

  The Court exercised its discretion to cram down the dissenting class on the basis that dissenting creditors would be no worse off under the restructuring plan as the company was also certain to enter administration if the plans were not approved due to the liquidity position of the companies.

  Notably, the Court did not accept an argument from a group of landlords that the restructuring plans were not just and equitable, as existing shareholders would retain their shares in full to the exclusion of the landlords and benefit from

184 *Re Virgin Atlantic Airways Ltd* [2020] EWHC 2376 (Ch); *Re DeepOcean I UK Limited* [2021] EWHC 138 (Ch); *Re Gategroup Guarantee Limited* [2021] EWHC 775 (Ch); *Re PizzaExpress Financing 2 Plc* [2020] EWHC 2873 (Ch); *Re Smile Telecoms Holdings Ltd* [2021] EWHC 685 (Ch); *Re Smile Telecoms Holdings Ltd* [2021] EWHC 933 (Ch); *Re Amicus Finance PLC* [2021] EWHC 2340 (Ch).

185 *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch).

the restructuring surplus, whereas the landlords would rank ahead of the shareholders in an administration (being the relevant alternative). This argument was rejected on the basis that the landlords were "out of the money" in the relevant alternative to the restructuring plans, and their objections had no weight as they "have no economic interest in the company". It was also held that the treatment of shareholders was appropriate given that shareholders were providing the appropriate amount of new money in return for their equity, on better terms than would be available in the market.

- In *DeepOcean,*[186] a company which formed part of the Netherlands based DeepOcean Group implemented a restructuring plan as part of a broader restructuring of the group. As part of the restructuring plan, the company's creditors were divided into four classes:

  (1) **Senior lenders**: the senior lenders under the group's syndicated facilities agreement agreed to contribute an additional US$15 million, and amend the terms of the facilities agreement and delay maturity until February 2025;

  (2) **Unsecured vessel owners**: under the plan, vessel owners would be entitled to recover approximately 5.2% of their claims;

  (3) **Unsecured landlords**: unsecured landlord creditors would receive approximately 4% of their total claims; and

  (4) **All other creditors**: all other creditors would be offered recoveries of between 4% and 8.2% of their claims.

  Under a Part 26 creditors' scheme of arrangement, the DeepOcean scheme would have failed on the basis that only 64.6% of unsecured creditors voted in favour of the scheme. However as Justice Trower was satisfied that both Conditions A and B were satisfied, the Court exercised its discretion to sanction the restructuring plan notwithstanding the failure of one class to vote in favour by the requisite majority. The Court agreed with the plan company that insolvency was the relevant alternative and was satisfied that the dissenting class of unsecured creditors had no genuine economic interest as they would not receive any return in the relevant alternative, as compared to the plan where they would receive a small dividend.

These restructurings would not have been able to be carried out (on this basis) in the absence of introduction of the new cross-class cram down power contained the new Part 26A. The *Virgin Active* decision is particularly significant in highlighting the flexibility of the restructuring plan to not only deal with financial creditors but also as a mechanism for tenants to restructure lease obligations, even where there is significant or even majority (in number) opposition to the proposed plan. The *Virgin Active* restructuring plan included landlord compromises calculated on the profitability of the relevant leases, with differential treatment applied across different portfolios of leases. This differential treatment resulted in a number of landlords with larger claims having deciding votes in certain classes — under a Part 26 scheme, those landlords would have been able to effectively "veto" the scheme. In addition, because the *Virgin Active* plan was also seeking to compromise secured liabilities, it facilitated a holistic compromise for the plan companies as compared to the CVA procedure, which is traditionally used to compromise landlord claims, but cannot compromise secured claims.

Commentary and feedback suggests that the UK and European restructuring market sees the restructuring plan mechanism as a very powerful tool in addition to the scheme of arrangement. Helpfully, the existing body of case law in relation to schemes can be

[186] *Re DeepOcean I UK Limited* [2021] EWHC 138 (Ch).

drawn upon by future courts and companies considering the new restructuring plan provisions.

It is apparent that the cross-class cram down feature of the Part 26A restructuring plan is allowing the cram down of not only junior finance creditors and shareholders, but also (in some cases) landlords and trade creditors. This is a significant departure from the traditional use of creditors' schemes of arrangement in the UK or in Australia (as discussed at section 4.4 above). It remains to be seen whether this broader usage of the cross-class cram down results in concerns as to the treatment of trade or other unsecured creditors in these circumstances, or whether any additional protections need to be considered in this regard.

It was also suggested to us that where a cross-class cram down is introduced there may be more parties resisting the effect of the scheme, and therefore there may be more situations where some form of stay or moratorium on steps taken to disrupt the operation of the scheme may be helpful. This also remains to be seen as the usage of the restructuring plan in the UK further develops.

(i) Rescue funding in the UK

In the UK, administrators have a statutory power to borrow funds and grant security over the property of a company (similar to the power of voluntary administrators to do so in Australia),[187] and it has been noted in the 2016 Review that the UK CVA framework permits a majority of a company's creditors to agree to a CVA proposal put forward by the company which grants new security over assets subject to a floating charge.

However these limited rescue financing mechanics are rarely used. The 2016 Review noted that this could possibly be because either: the funding will typically come from the existing floating charge holder, who has no need to vary their existing security, and any assets not covered by the floating charge will already be subject to fixed charges; or existing negative pledge clauses will preclude a new funder from being granted satisfactory security to provide finance.[188]

The 2016 Review initially contemplated introducing rescue finance reforms in a similar form to Chapter 11 of the US Bankruptcy Code as part of the CIGA. The 2016 Review proposed:

- re-ordering the priority of administration expenses to encourage rescue finance;
- the introduction during administration and debtor-in-possession rescue of provisions permitting companies to grant security to new lenders over company property already subject to fixed charges, which would rank as a first or equal first charge or an additional but subordinate charge on the property; and
- providing safeguards for existing charge holders.[189]

However these reforms were not taken forward.[190] The 2018 *Review of Insolvency and Corporate Governance* summarised the reasoning behind the decision not to progress the rescue financing reforms further:

> While there was some support for the [rescue finance] proposals, much of it qualified, the Government was persuaded by the arguments put forward by the large majority of

187 *Insolvency Act 1986* (UK) sch 1.

188 The Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform* (Consultation, 25 May 2016) [10.8]–[10.10].

189 The Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform* (Consultation, 25 May 2016) [10].

190 Department for Business, Energy & Industrial Strategy, I*nsolvency and Corporate Governance: Government response* (Response, 26 August 2018) [5.177]–[5.186].

respondents who were opposed to the measures. In particular, respondents' experience that such measures were not necessary, as the market already functioned well in offering rescue finance to viable businesses, and the potentially serious and negative consequences on lending if measures were introduced, provided compelling reasons not to legislate in this area. Few, if any, respondents expressed confidence that the proposed safeguards would be without problems, with many suggesting that the potential for litigation would be considerable. The Government has therefore decided not to proceed with the rescue finance proposals at this time, but will keep the issues under review.[191]

191 Department for Business, Energy & Industrial Strategy, I*nsolvency and Corporate Governance: Government response* (Response, 26 August 2018) [5.186].

6 Automatic moratorium for creditors' schemes of arrangements

6.1 Overview

In this section we address the key proposal contained in the Consultation Paper — the introduction of an automatic moratorium in respect of creditors' schemes of arrangements.

In our view introducing such a mechanism is unnecessary, and would not provide any significant benefits in respect of the use of creditors' schemes of arrangement as they are used in the restructuring process in Australia. Creditor schemes' of arrangement are generally used to undertake private, out-of-court restructuring in respect of finance creditors, where there are already adequate restrictions on unilateral enforcement contained in the finance documents. To the extent there are any "gaps" in these contractual regimes they are largely addressed by the availability of section 411(16) orders.

Furthermore, the TMA is of the view that it is important to recognise what a significant development the introduction of a broad ranging automatic moratorium would be, it is — in effect — introducing a whole new debtor-in-possession insolvency regime into Australia's legislative landscape.

Such a step gives rise to a significant number of issues that would need to addressed, as we explain in sections 6.3–6.11 below, including the need for appropriate oversight and creditor protections, the treatment of transactions with the company during the moratorium period, the requirements for appropriate disclosure and transparency, the perspective of the credit markets on such a regime, and the issues with disruption and damage to the business which is inherent in a broad ranging moratorium.

Given the complexity of these issues, we see little benefit in introducing a broad ranging debtor-in-possession style moratorium that is tied to creditors' schemes of arrangement.

As we have discussed, by their nature, creditors' schemes of arrangement are only used rarely and then by large companies.[192] Whilst the TMA considers there is merit in exploring adoption of a debtor-in-possession style restructuring regime in Australia, the TMA believes it would make more sense to consider this on a standalone basis so it would have broader application. However, prior to pursuing such significant law reform in this space, it would be appropriate for the Government to undertake a holistic review of the corporate restructuring and insolvency laws in Australia, rather than adopting a piecemeal approach.

We do think there could be merit in some limited adjustments to section 411(16) of the Corporations Act to ensure that these orders are available to deal with any situations where the existing contractual arrangements leave possible issues, which we explain at section 6.13 below.

6.2 What is the Consultation Paper proposing?

The Consultation Paper provides limited details regarding the features and scope of the proposed automatic moratorium for creditors' schemes of arrangement.

192 See section 4.3 above.

However, it is appears from the Consultation Paper that the proposed automatic moratorium in respect of creditors' schemes of arrangement might have the following features:

- **automatic stay**: the moratorium would be "automatic" in that it would take immediate effect upon some trigger. The company would not, for example, need to obtain a court order in order to enjoy the benefit of the moratorium (in contrast to the current section 411(16) orders). It is unclear what the trigger event for accessing the moratorium would be;
- **broad stay**: the scope of the moratorium is proposed to align with that applying in a voluntary administration under sections 440A–440F of the Corporations Act — ie it would be a broad moratorium staying winding up applications, legal proceedings, security enforcement and repossession of leased assets;
- **stay of all creditors**: whilst not entirely clear from the Consultation Paper, it appears to be envisaged that the stay would apply to all creditors of the company, in the same way as the voluntary administration stay (potentially with a corresponding exclusion allowing enforcement by a secured creditor with security over the whole or substantially the whole of the company's assets if enforcement is undertaken in the decision period). In other words, it appears that the stay would not just apply to the creditors subject to the proposed creditors' scheme of arrangement; and
- **starting point**: it appears that the stay would be available at some point before the first court hearing. The Consultation Paper notes that the earlier the moratorium becomes available the more effective it will be in providing "breathing space", while acknowledging the need to balance this with creditor rights. It is however otherwise unclear how early on the moratorium might be available.

It also appears that the Government envisages that the directors and management would remain in control of the company through the moratorium period.[193]

6.3 Is there a need for an automatic moratorium for creditors' schemes of arrangement?

(a) There is no need for the introduction of an automatic moratorium for creditors' schemes of arrangement

In the TMA's view there is no need for an automatic moratorium to be introduced in respect of creditors' schemes of arrangement.

Any proposal to introduce an automatic moratorium in respect of creditors' schemes of arrangement would be based on a misunderstanding of:

- how creditors' schemes of arrangement are used in practice as part of a restructuring;
- the mechanics already available to companies and creditors to address any concerns regarding creditors enforcing rights so as to undermine creditors' schemes of arrangement; and

193 We note that the Consultation Paper states that "[a] financially distressed company may not obtain the full benefits of any automatic moratorium if its directors are concerned that trading the business during the scheme process may expose them to personal liability for insolvent trading". This appears to presupposes that the directors remain in control during the moratorium.

- the fact that a significant part of the benefit of a creditors' scheme of arrangement is that it does ***not*** interfere with the rights of stakeholders beyond the specific financial creditors subject to the scheme of arrangement.

We explain this in further detail in the following sections.

(b) Why is the automatic moratorium proposed in the Consultation Paper?

The Consultation Paper does not provide much explanation as to the reason for proposing, or the expected benefit in enacting, an automatic moratorium in respect of creditors' schemes of arrangement.

The following passage in the Consultation Paper appears to outline the reason for the proposal, indicating that the genesis of the idea was issues noted in the Productivity Commission's 2015 report on "Business set-up, transfer and closure" (the **PC Report**):

> The Productivity Commission also noted issues associated with the lack of an automatic moratorium on creditor actions during the formation of a scheme. While the Court can grant a moratorium once a scheme is 'proposed', there is no guarantee that the Court will do so which may create uncertainty and ultimately affect the utility of the process. This sets schemes apart from other insolvency processes like voluntary administration and small business debt restructuring, both of which automatically apply wide protections against creditor actions upon the commencement of the process.
>
> The Commission recommended that the Corporations Act be amended to create a moratorium on creditor enforcement during the formation of schemes of arrangement and that this moratorium be aligned with the approach used in voluntary administration. It also recommended that Courts be given the explicit powers to lift all or part of the moratorium in circumstances where its application would lead to unjust outcomes.

The Consultation Paper appears to be referring to the following comments made in the PC Report in support of an automatic moratorium:

> Unlike Deeds of Company Arrangement, schemes can, in theory be entered into separately from other insolvency processes (specifically voluntary administration). However, in practice, a lack of a moratorium on creditor actions during a scheme creates a risk that individual creditors can undermine the attempts of the scheme to restructure the company, or use the threat of action to extract favourable concession (Arnold Bloch Leibler, sub. 23, pp. 11-2). As such moratoriums are available in voluntary administration, companies have some incentive to seek that protection.[194]

These comments in the PC Report appear in turn to be based on Arnold Bloch Leibler's submissions[195] (**ABL Submissions**) to the Productivity Commission, which made the following comments regarding a moratorium for schemes of arrangement:

> [3.37] In recent years, schemes of arrangement under Part 5.1 of the Corporations Act have been successfully utilised to facilitate large, complex corporate reconstructions of distressed enterprises including the Centro Group Alinta and Nine Entertainment. As suggested above, this has been, at least in part, to avoid the stigma and loss of value associated with the voluntary administration regime.
>
> [3.38] There are, however, disincentives for distressed (but not insolvent) companies to undergo a scheme of arrangement because of the risk that creditors can enforce rights during the period in which the scheme is being propounded and implemented. There is no statutory moratorium on creditor enforcement actions in respect of schemes of arrangement until the compromise or arrangement becomes binding under s 411(4) of the Corporations Act. This allows creditors with readily enforceable rights to disrupt, or undermine, reconstruction attempts or extract disproportionate concessions.

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194 Productivity Commission, *Business set-up, transfer and closure* (Report No 75, 30 September 2015) 357.

195 Arnold Bloch Leibler, Submission No 23 to Productivity Commission, *Business Set-Up, Transfer and Closure* (25 February 2015) <https://www.pc.gov.au/inquiries/completed/business/submissions>.

> [3.39] In order enhance the utility of schemes as a means of reorganising distressed but not insolvent companies, we believe that a moratorium on creditor enforcement actions (subject to Court supervision) be introduced into s 411 of the Corporations Act.

We note that neither the ABL Submissions, nor the PC Report, mention the existence of section 411(16), which allows the court to make orders retraining legal proceedings in respect of the company once a scheme has been proposed.

However, regardless of this, we are of the view that the concerns referenced or expressed in the Consultation Paper, the PC Report and ABL Submissions are largely misplaced. We explain the reasons for this in the following sections.

(c) There is a scheme moratorium power already

It is important to note that there is already a moratorium power available under section 411(16) of the Corporations Act. We discuss section 411(16), and where it has been used to prevent creditor enforcement while a scheme is propounded and implemented, at section 4.7 above.

Whilst the moratorium available under section 411(16) is not as broad as the moratorium available in administration, in practice it can still be used to constrain most actions that might upset a potential scheme of arrangement.

In *Ovato* for example, Black J made an order "Pursuant to s 411(16) of the *Corporations Act 2001* (Cth), all further proceedings in any action or any other civil proceeding against any or all of the Plaintiffs (whether or not such action or proceeding has already been commenced) be restrained except by leave of the Court and subject to such terms as the Court imposes".[196] However, despite the availability of this potentially powerful order under section 411(16), it has been used rarely in respect of creditors' schemes of arrangements. This suggests that the apparent concern that a lack of a moratorium on creditor actions during a scheme creates a risk that individual creditors can undermine the attempts of the scheme to restructure the company, or use the threat of action to extract favourable concession, is not a real or actual concern in practice.

(d) Creditors' schemes generally proceed without moratoriums

As noted at section 4.3 above, we have reviewed all of the creditors' schemes of arrangement (of which we are aware) implemented in Australia since 2008.

Of the 19 creditors' schemes of arrangement (in total) during this period, only 3 of the scheme companies sought moratorium orders under section 411(16) of the Corporations Act. Whilst five of these companies were already in external administration (and therefore had no need for a further moratorium) this still indicates that the majority proceeded without any form of statutory or court based moratorium.

These numbers clearly evidence that, in practice, the availability of a statutory moratorium is not a necessary requirement for distressed companies to successfully undertake a creditors' scheme of arrangement to restructure their debts.

(e) Schemes are generally used to restructure finance debt

The reason why moratoriums are, generally, not required in respect of restructurings undertaken by way of creditors' schemes of arrangement, is because they are restructurings of finance debt only.

This is again illustrated by the survey of creditors' schemes of arrangement discussed at section 4.3 above, which indicates that of the 15 creditors' schemes of arrangement used to carry out a restructuring all but one of these schemes only related to the finance debts of the company.

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196 Order of Justice Black in *Re Ovato Print Pty Ltd* (2020/00323408, 13 November 2020).

As we discuss at section 4.4 above, creditors' schemes of arrangement are used as a tool to implement private "out-of-court" restructurings between a company and its finance creditors. By their nature these restructurings do not extend to trade or other creditors, and it would generally be damaging to the business, and ultimately, the outcome for the financial stakeholders for it to do so.

Creditors' schemes of arrangements are only required where the financing is large, and broadly held, such that it is impossible or impractical to obtain unanimous consent from the finance creditors to the deal. In such circumstances, the creditors' scheme of arrangement can be used to bind the dissenting minority to the restructuring otherwise negotiated and agreed by the majority of financiers with the company.

(f) Finance debt generally has built in collective enforcement mechanics

Accordingly, in practice, creditors' schemes of arrangement are used to bind dissenting minorities of finance creditors in respect of situations where the finance debt is widely held.

Widely held financial debt of this type is generally structured as either:

- a syndicated loan agreement; or
- a note or bond issuance.

The agreements or indentures documenting such financial debt invariably contain provisions mandating that key enforcement steps may only be undertaken by a requisite majority of lenders or other financiers under the instrument. These collective enforcement provisions effectively give rise to a "de facto" stay unless a majority of financiers wish to enforce.

For example, under a typical syndicated loan agreement used in the Australian market, acceleration of the loan (following an event of default) may only be undertaken by the facility agent. The facility agent is only required to accelerate the loan upon receiving instructions to do so from the "Majority Lenders", typically being holders of 66⅔% of the loans.

Similarly, where the debt is widely held any security will generally be held for the benefit of the collective financier group by a security trustee. Under typical security trust arrangements the security trustee will only enforce the security upon (among other things) receiving instructions to do so from the "Majority Beneficiaries" (or a similar concept), typically being holders of 66⅔% of the finance debt secured by that security.

Accordingly, in practice, debt acceleration and security enforcement steps can only be undertaken where a majority of the lenders agree to take such steps. In such scenarios there would be no prospect of a creditors' scheme of arrangement being approved by those lenders, and therefore any moratorium would be pointless.

Correspondingly, where there is not a majority of the lenders who wish to take steps to enforce, there is a "de facto" standstill, whereby a dissenting minority lender cannot accelerate the debt or enforce the security while the creditors' scheme of arrangement is being negotiated or implemented.

It is therefore recognised that modern financing documentation has largely obviated the need for any moratorium in respect of creditors' schemes of arrangement.[197]

[197] Sarah Paterson, 'Rethinking Corporate Bankruptcy Theory in the Twenty-First Century' (2016) 36(4) *Oxford Journal of Legal Studies* 697.

(g) Subordination mechanics put a standstill on junior creditors

In addition to the collective enforcement mechanics applying to syndicated loans or bonds, there may also be subordination or intercreditor agreements in place with any finance creditors intended to rank "senior" in priority to the "junior" finance debt.

Whilst the precise terms of these subordination provisions vary between transactions, the consistent purpose of these arrangements is to prevent junior creditors from enforcing their claims against group companies in a way that could prejudice a restructuring or enforcement by the senior lenders. For example, an intercreditor agreement may restrict a junior creditor from taking enforcement action for 180 days following a payment default. This period is intended to give the company and senior lenders sufficient time to negotiate and carry out a restructuring (or controlled enforcement).

(h) Gaps in the contractual matrix are generally addressed

There are certain instances where the de-facto standstill or stay, as outlined in section 6.3(f) above will not be applicable, and individual lenders may take individual action against a company. The circumstances where this may arise are:

- **due and unpaid finance debts**: in the event that a payment of interest or principal has fallen due under the (senior) debt documents to lenders and such amount has not been paid.

  In this case, individual lenders may be entitled to petition for the debtor company to be wound up (on grounds of insolvency) or to sue the debtor company for the payment due (although bond documents in particular will frequently restrict this also). However to the extent an individual lender has such remedies, these rights would be amenable to being stayed pursuant to an order under section 411(16), provided that a scheme of arrangement had been "proposed" (see section 4.7 above). It should also be noted that even in non-payment scenarios the "de facto" stay would generally still apply in respect of acceleration or security enforcement steps; and

- **bilateral loans**: where the (senior) debt is held in bilateral instruments with a number of lenders and those bilateral instruments do not contain any collective enforcement clauses.

  In practice, this is rarely seen (outside of certain asset financing arrangements, which are generally, by their nature, not particularly amenable to a scheme of arrangement process) as generally only "blue chip" corporates are able to borrow from a sufficient number of lenders on this sort of bilateral basis for a creditors' scheme of arrangement to be relevant (and therefore, by their status are not expected to be at risk of default).[198]

  In any event, as noted above, section 411(16) would also be available to restrain individual proceedings or winding up petitions by such lenders once a scheme was proposed (and any security would generally be held by a security trustee and subject to a collective enforcement regime as described at section 6.3(f) above).

Accordingly, we do not consider these issues operate to undermine the effectiveness of the creditors' scheme of arrangement in practice. This is particularly the case given that well advised companies generally seek to engage in restructuring discussions with their financiers before the occurrence of a payment default under their finance documents.

[198] This sort of scenario did arise in respect of the restructuring / insolvency of Arrium, but for the reasons given, we consider this to be an outlier situation.

To the extent there are concerns regarding these possible "gaps" in the existing creditors' scheme of arrangement regime, the TMA considers the best way of addressing this would be to make some relatively minor adjustments to the existing section 411(16).

We discuss such adjustments to section 411(16) further at section 6.13 below.

(i) Standstill agreements and waivers

We also note that as a matter of restructuring practice, where a company is engaging with its lenders in respect of a potential restructuring, which may ultimately be implemented by way of a creditors' scheme of arrangement, it is common for the lenders (or a supporting sub-set of such lenders) to enter into a formal standstill agreement with the company.

Such an agreement provides the company with additional comfort that it has a stable basis to pursue the restructuring and scheme of arrangement. Supporting lenders may also elect to waive certain defaults by the company to also provide some degree of breathing room.

(j) Moratorium not sought or needed from trade creditors

Finally, as discussed at section 4.4 above (and demonstrated by the actual use of creditors schemes of arrangement in Australia discussed at section 4.3 above), creditors' schemes of arrangement are generally not used to restructure or compromise trade debts.

This is because the damage (or the potential risk of damage) done to the value of the business through the negative publicity, disruption and interference with supplier and customer relationships is in most cases significant, and unlikely to result in sufficient reduction in the company's liabilities to outweigh the impact of this damage.

In practice, where a financial restructuring is pursued, the financial creditors and the company will seek to privately agree the restructuring and any sharing of losses between them, such that when the creditors' scheme of arrangement is announced, a positive message can be given to the company's trade creditors and other stakeholders that the issues are "resolved", that the company will continue to operate as normal and that all trade creditor claims will continue to be paid in the normal course. A moratorium in respect of trade creditors and other creditors clearly runs contrary to this "good news" narrative.

Indeed, recognising this commercial reality, supportive financial creditors will often assist the company manage its liquidity position during the period where the restructuring is being developed and negotiated, to ensure these trade creditors continue to be paid. This support can be provided by the financiers agreeing deferrals or capitalisation of interest or principal due under the finance documents, or by advancing additional interim funding to the company (typically on a priority basis).

(k) A broader moratorium is available, if required, through administration

As noted in the ABL Submissions, a broader moratorium, of the sort contemplated in the Consultation Paper, is available where required, in the form of the existing voluntary administration procedure. A creditors' scheme of arrangement can be proposed or implemented by a company from within voluntary administration if that is the most appropriate course in the circumstances (as demonstrated by the Quintis scheme — see section 4.3 above).

It is not apparent to us why voluntary administration would not be the appropriate approach should the company have unpaid and unmanageable creditor claims that could not otherwise be resolved through the mechanisms described above. As Professor Harris has noted, further adjustments could also be made to the voluntary arrangement process to make it easier and more efficient to use the creditors' scheme of arrangement process

within the voluntary administration regime, rather than imposing an automatic moratorium on the creditors' scheme of arrangement process.[199]

(l) No scheme of arrangement (or restructuring plan) moratorium in the UK

It is also important to note that, as discussed at section 5.4(c) above, the UK has no statutory moratorium provisions in respect of either a creditors' scheme of arrangement or the new UK restructuring plan. The UK has no statutory equivalent to section 411(16) of the Corporations Act, although this gap has been somewhat ameliorated by the courts on occasion staying legal proceedings against the company through reliance on rules of civil procedure (see section 5.4(c) above).

Nevertheless, the UK has become a global leader in cross border restructuring. Distressed companies across Europe, and around the world, actively seek to use the UK creditors' scheme of arrangement procedure (and now the restructuring plan procedure), and it is generally considered to be a very effective restructuring tool, particularly for dealing with overleveraged companies.

The UK's success in this regard has not been hampered by the lack of any moratorium of the type contemplated under the Consultation Paper. Furthermore, there continues to be no significant demand for such a feature to be introduced in the UK.[200] The UK Government saw no need to introduce such a feature as part of the recently introduced restructuring plan process (see discussed at section 5.4(g) above) when the CIGA was enacted.

In theory, the UK's Part A1 Moratorium, a standalone debtor-in-possession moratorium introduced at the same time as the restructuring plan, could be coupled with a creditors' scheme of arrangement or restructuring plan in some circumstances. However, in practice the Part A1 Moratorium has proved largely unworkable (for reasons discussed at section 5.4(f) above) and has hardly been used (and to our knowledge it has not been used with schemes of arrangement or restructuring plans).

The reason that the UK has seen no need to introduce a creditors' scheme of arrangement related moratorium is essentially the same reasons as set out in sections 6.3(c) to 6.3(k) above (and because creditors' schemes of arrangement are used in the UK in the manner outlined in section 4.4 above).

6.4 A scheme of administration automatic moratorium is effectively a new debtor-in-possession regime

It is important to recognise the scope and significance of the automatic moratorium proposed in the Consultation Paper.

A moratorium which restricts all creditors from enforcing their contractual rights against the company, enforcing their security or recovering their assets is a significant interference with those creditors' contractual and proprietary rights.

Such interference is justified where the company is insolvent, and therefore not all creditors can be paid. In such circumstances insolvency laws provide for the imposition of collective insolvency proceedings (in Australia, either voluntary administration or liquidation) that have the purpose of maximising the overall recovery for creditors and ensuring fair and equitable treatment between creditors and their existing rights.

If a broad automatic moratorium of the type envisaged in the Consultation Paper is to be adopted, it would, in our view, be critical to ensure that such a moratorium includes the

199 Jason Harris, 'Promoting an optimal corporate rescue culture in Australia: The role and efficacy of the voluntary administration regime' (PhD Thesis, University of Adelaide, 2021).

200 Sarah Paterson, 'Reflections on English Schemes of Arrangement in Distress and Suggestions for Reform' (2018) 15(3) *European Company and Financial Law Review* 472.

conventional protections and hallmarks of a formal insolvency regime. This would include some form of appropriate:

- oversight and control of the company, its assets and operations;
- transparency and disclosure as to the company's financial position;
- restriction on payments, disposals of property and the granting of security;
- regime for the priority payment of debts necessarily incurred during the moratorium process; and
- requirement that the company's activities be directed towards a restructuring or other outcome that maximises returns for creditors.

Furthermore, it would also be important to ensure that the moratorium process operated in a manner that was consistent with existing insolvency law.

We discuss some of these issues, that would need to be worked through, should the Government introduce a debtor-in-possession moratorium of this nature, in more detail in sections 6.5 to 6.11 below.

6.5 Moratorium oversight, creditor protection and safeguards

Should the Government choose to introduce a broad "debtor-in-possession" style moratorium in respect of creditors' schemes of arrangement, consideration would need to be given to ensuring there are adequate measures to ensure oversight of the company's activities, protection of creditors and prevention of abuse.

(a) The need for oversight and safeguards

As a starting point, it is worth noting why oversight and creditor protection may be required in respect of a debtor-in-possession moratorium process.

Where a company is insolvent, and there is no realistic prospect of return to shareholders, the shareholders have no economic interest in the company.[201] Any gains or losses of the company will be for the benefit or detriment of the creditors, rather than shareholders. This has been described as a "virtual ownership" of the company's assets (and perhaps the company itself) by the company's creditors.[202]

This shift in economic entitlement has been reflected, to some extent, in the case law on director's duties where a company is insolvent or approaching insolvency, requiring directors to "take into account" the interests of creditors.[203] However, the extent and bounds of this duty remain unclear.

This is significant, as a debtor-in-possession moratorium (as opposed to a process where an external administrator is appointed, such as voluntary administration) prevents creditors' from exercising their own rights to protect their interests, whilst leaving directors in control. These directors will have been appointed by the shareholders, whose interests are underwater, and therefore not "aligned" with creditors. The shareholders will also be able to exercise control of the actions of the directors and the company through shareholder resolutions, including ultimately the power to remove directors.

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201 This is a longstanding principle of English and Australian law – see for example *Re Tea Corporation* [1904] 1 Ch 12.

202 Stephen Madaus, 'The position of shareholders in a restructuring' in Paul Omar and Jennifer Gant (eds), *Research Handbook on Corporate Restructuring* edited by Paul Omar and Jennifer Gant (Edward Elgar Publishing, 2021) 185, 185–6.

203 *Walker v Wimborne* (1976) 137 CLR 1; *Kinsella v Russell Kinsela Pty Ltd* (1986) 4 NSWLR 722. Cf *The Bell Group Ltd v Westpac Banking Corp (No 9)* [2008] WASC 239.

A risk in such scenarios is that the company, and its directors, will be influenced by a desire to retain value or control for shareholders, rather than acting to maximise returns for creditors. It could also, in some circumstances, give management perverse incentives to pursue reorganisation even where liquidation is more appropriate.[204]

Further, where there is a moratorium in place, creditors will be on the "sidelines" and unable to exercise their contractual or statutory rights to protect their own positions.

As stated by Christoph G Paulus and Reinhard Dammann:

> The imposition of the stay changes the balance of power between creditors and shareholders/management profoundly. Debt performs its functions in corporate governance only if the threat of individual enforcement of the fixed debt claim is credible. The stay, for reasons explained in the commentary on Article 2 par. 1 no. 4 and on this Article 6, takes away the right of individual enforcement. Doing this, it potentially gives shareholder and managerial opportunism a free reign. To mitigate this risk, Member States would be well advised to consider legislating for limitations and checks on shareholder/managerial powers while the debtor enjoys the protection of they stay.[205]

Furthermore, even where directors have appropriate regard to creditors' interests, they may or may not have the competence or abilities to make the right decisions in the context of navigating corporate distress. This also gives rise to the need for some degree of oversight and protection.

(b) Oversight

While debtor-in-possession procedures such as moratoriums are becoming increasingly common in international restructuring systems, it is generally recognised that some level of oversight is required to ensure the rights of other stakeholders are protected (including for the reasons discussed in the previous section).

The EU Restructuring Directive notes the following regarding the oversight of companies who enjoy a general stay on enforcement actions:

> To avoid unnecessary costs, to reflect the early nature of preventive restructuring and to encourage debtors to apply for preventive restructuring at an early stage of their financial difficulties, they should, in principle, be left in control of their assets and the day-to-day operation of their business. The appointment of a practitioner in the field of restructuring, to supervise the activity of a debtor or to partially take over control of a debtor's daily operations, should not be mandatory in every case, but made on a case-by-case basis depending on the circumstances of the case or on the debtor's specific needs. Nevertheless, Member States should be able to determine that the appointment of a practitioner in the field of restructuring is always necessary in certain circumstances, such as where: the debtor benefits from a general stay of individual enforcement actions; the restructuring plan needs to be confirmed by means of a cross-class cram down; the restructuring plan includes measures affecting the rights of workers; or the debtor or its management have acted in a criminal, fraudulent, or detrimental manner in business relations.
>
> For the purpose of assisting the parties with negotiating and drafting a restructuring plan, Member States should provide for the mandatory appointment of a practitioner in the field of restructuring where: a judicial or administrative authority grants the debtor a general stay of individual enforcement actions, provided that in such case a practitioner is needed to safeguard the interests of the parties; the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram down;

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[204] Christoph G Paulus and Reinhard Dammann *European Preventive Restructuring: An Article-by-Article Commentary* (Beck Hart Nomos, 2021) 98–9.

[205] Christoph G Paulus and Reinhard Dammann *European Preventive Restructuring: An Article-by-Article Commentary* (Beck Hart Nomos, 2021) 123.

it was requested by the debtor; or it is requested by a majority of creditors provided that the creditors cover the costs and fees of the practitioner. [206]

All regimes which allow the debtor to remain in control of its operations have some level of oversight or supervision of the company while it is protected from its creditors. Generally, there are two mechanisms which are relied upon to ensure that there is a level of oversight during a moratorium or stay:

- the appointment of an insolvency practitioner to monitor the company's activities; or
- heightened court supervision of the company and process.

Oversight via an insolvency practitioner

In the UK, the Part A1 Moratorium relies primarily upon oversight by the insolvency practitioner who acts as the "monitor" of the company. We discuss the Part A1 Moratorium in more detail at section 5.4(d) above.

A broadly similar approach has been endorsed by the EU Restructuring Directive. However, under the Article 5 of the EU Restructuring Directive, appointment of an insolvency practitioner is not compulsory in all cases, but instead there is more flexibility depending on what is appropriate in the circumstances:

1. Member States shall ensure that debtors accessing preventive restructuring procedures remain totally, or at least partially, in control of their assets and the day-to-day operation of their business.
2. Where necessary, the appointment by a judicial or administrative authority of a practitioner in the field of restructuring shall be decided on a case-by-case basis, except in circumstances where Member States may require the mandatory appointment of such a practitioner in every case.
3. Member States shall provide for the appointment of a practitioner in the field of restructuring, to assist the debtor and creditors in negotiating and drafting the plan, at least in the following cases:
   (a) where a general stay of individual enforcement actions, in accordance with Article 6(3), is granted by a judicial or administrative authority, and the judicial or administrative authority decides that such practitioner is necessary to safeguard the interests of the parties;
   (b) where the restructuring plan needs to be confirmed by a judicial or administrative authority by means of a cross-class cram-down, in accordance with Article 11; or
   (c) where it is requested by the debtor or by a majority of the creditors, provided that, in the latter case, the cost of the practitioner is borne by the creditors.

Singapore "light touch" approach

The Singapore scheme moratorium has, in effect, become a debtor-in-possession process without the oversight of an insolvency practitioner, and with fairly minimal court involvement. (See the more detailed discussion on the Singapore scheme moratorium at section 5.3(b) above.)

This lack of appropriate control and oversight of Singapore companies undergoing a scheme moratorium has been a significant concern raised by all of the Singapore restructuring professionals we have spoken to (see section 5.3(e) above).

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206 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 [2019] OJ L 172/18, 6 [31]–[32] (**EU Restructuring Directive**).

We therefore do not consider it would be appropriate for Australia to adopt the Singapore approach of a broad moratorium that is largely unsupervised, and we are concerned that taking such an approach would undermine confidence in Australia's insolvency and restructuring framework.

Oversight via the Courts

In contrast to the approach adopted in the UK and Europe, Chapter 11 of the US Bankruptcy Code involves a significant level of court control and oversight of the company and restructuring process through specialised federal bankruptcy courts.

The cost associated with the high level of court involvement in Chapter 11 has given rise to concerns, even in the US. The *Final Report of the Commission to Study The Reform of Chapter 11* stated:

> A common critique of chapter 11 is that it is too expensive: distressed companies cannot afford to file for bankruptcy and engage in the process of reorganizing under the protections of the Bankruptcy Code. Although commentators debate the accuracy of this statement, the perception persists that chapter 11 is cost-prohibitive for many distressed companies.
>
> …
>
> Additionally, the increasing cost of chapter 11 has had a significant impact on the perceived ability — and perhaps actual ability — of small and middle-market companies seeking restructuring options to invoke chapter 11. One commentator observed that, based on a small sampling of cases filed in 2010 in the Southern District of New York, "professional fees for the middle-market Chapter 11 cases typically approached or exceeded $1 million." This commentator suggested that high professionals' fees, among other factors, have encouraged lawyers representing middle-market companies to pursue alternatives to traditional chapter 11 reorganization, such as section 363 asset sales on an expedited basis, followed by a liquidating plan, or to invoke alternatives under state law, including general assignments for the benefit of creditors and composition agreements to restructure debt. Although this particular study was limited in size and geographic area, the commentator's findings mirror the testimony and anecdotal evidence presented to the Commission during its study process.[207]

These costs seem difficult to justify in connection with the smaller companies in the Australian market. The United States has also developed a specialist court division and judiciary to oversee the Chapter 11 process, infrastructure that would likely be challenging and expensive to develop in Australia.

It is also notable that CAMAC considered whether to introduce a system based on Chapter 11 into Australian law in its 2004 Report on rehabilitating large and complex enterprises in financial difficulties (**CAMAC Report**).[208] CAMAC did not recommend adoption of a Chapter 11 style debtor-in-possession system, and the extensive court supervision required under such a model was one of the reasons for it reaching that conclusion.[209]

Preferred approach to oversight

If a broad debtor-in-possession style regime was to be adopted in Australia, the TMA is of the view that the UK or European approach of supervision by way of some form of

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207 American Bankruptcy Institute, *Final Report of the Commission to Study The Reform of Chapter 11* (Final Report, 2014) 56–8.

208 Corporations and Markets Advisory Committee, *Rehabilitating large and complex enterprises in financial difficulties* (Final Report, 7 October 2004).

209 Corporations and Markets Advisory Committee, *Rehabilitating large and complex enterprises in financial difficulties* (Final Report, 7 October 2004) 17. See also generally Ahmed Terzic, 'Turning to Chapter 11 to foster corporate rescue in Australia' (2016) 24(1) *Insolvency Law Journal* 5.

monitor or other insolvency practitioner role is likely to be more cost effective and practical than adopting the United States court based approach.

That being said, the Part A1 Moratorium has had very limited use in the UK to date, and a number of concerns have been raised about its operation and general feasibility (see section 5.4(f) above), so it is clear that adopting this approach would also require careful consideration. Whilst the EU Restructuring Directive provides some useful guidance, it is not well enough developed to provide a suitable model by itself (and certain key issues are not addressed by the Directive).[210]

(c) Initiation and conditions

Our view is that a company should only be able to access a broad debtor-in-possession moratorium in respect of a creditors' scheme of arrangement process upon application to the court, such that the court could assess the appropriateness of the moratorium and whether it is likely to prejudice creditors.[211]

To assist the court in making such a determination, the company should demonstrate to the court:

- why granting the moratorium would be in the interests of creditors;
- whether material prejudice would be suffered by creditors as a whole, or unfair prejudice by any creditors, should the moratorium order be granted and whether such prejudice could be alleviated through a term of the court's order;
- that the company has a viable restructuring plan to be implemented during the moratorium period;
- the likely time period to implement that plan, and that the company has sufficient funding to be able to continue operating throughout that period; and
- the degree of support or opposition expressed by creditors to the moratorium or the broader restructuring.[212]

The court should only grant a moratorium order where, having regard to all of these matters, and any other things that it considers relevant, the court considers it appropriate to exercise its discretion to grant such an order. The court should also be entitled to make the moratorium order subject to any exceptions, limitations or conditions it considers appropriate.

(d) Time limits and termination

The Singapore experience also demonstrates the importance of setting time limits for debtor-in-possession moratoriums, and careful scrutiny of any requests of extensions.

We believe that, in line with the voluntary administration process, any moratorium should be granted for a short period, with any extension requiring an order of the court. The court would need to consider the matters outlined in section 6.5(c) when determining whether to grant such an extension.

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210 For example, as noted by Christoph G Paulus and Reinhard Dammann *European Preventive Restructuring: An Article-by-Article Commentary* (Beck Hart Nomos, 2021) 123: "The Directive is consciously silent on the stay's impact on the debtor, in particular, on the debtor's duties and rights to deal with its own property while under the protection of the stay."

211 We note a different "out-of-court" voluntary filing approach may be appropriate if there was a properly developed "standalone" debtor-in-possession process with appropriate oversight and safeguards. However, where there is little in the way of other protections built into the regime we consider that initiation by court order is critical to ensure some degree of oversight.

212 Where it is demonstrated that there are creditors opposed to the moratorium or restructuring that would be sufficient to prevent the creditors' scheme of arrangement from passing, the moratorium order should not be made (or if already granted, it should be lifted) as in these circumstances the objective of the moratorium is no longer achievable.

We further consider that the court should have the ability to terminate or vary the moratorium, in whole or in part, upon the application of the company or any creditor. Grounds for terminating or varying the moratorium would include the restructuring no longer being viable or unfair prejudice to a creditor, but the court should have broad discretion to make orders in this regard as it considered fit in the circumstances.

6.6 Transactions during the moratorium period - insolvency considerations

The Consultation Paper indicates that the automatic moratorium in respect of schemes of arrangement would be of similar broad scope to the moratorium that currently applies in relation to voluntary administration.

The need for such a moratorium implies that the company is insolvent (in accordance with section 95A of the Corporations Act) and unable to pay its debts as and when they fall due. If the company is unable to pays its debts, then payments and other transactions by the company during the period may have the effect of preferring one creditor over another, or dissipating value to the detriment of creditors as a whole.

This therefore raises the question as to how transactions undertaken by the company during the moratorium period should be treated in the context of the broader Australian insolvency law framework, including:

- should there be any restrictions on the company's ability to enter into transactions during the moratorium period;
- should transactions entered into during the moratorium period be at risk of clawback as voidable transactions in a subsequent liquidation; and
- whether debts incurred by the company during the moratorium period need priority treatment in a subsequent liquidation.

We discuss these issues in the following sections.

(a) Restrictions on payments and other transactions

As noted above, if a company is unable to pays its debts, then payments and other transactions by the company may have the effect of preferring one creditor over another, or dissipating value to the detriment of creditors as a whole.

In a voluntary administration creditors are protected from this risk by the administrator having control of the assets of the company, the administrator's duties to creditors and section 437D of the Corporations Act, which renders any transaction or dealing affecting property of the company void unless entered into or consented to in writing by the administrator.

In the case of debtor-in-possession regimes there are typically restrictions on the ability of the company to make payments, dispose of property, grant security or incur debt other than in the ordinary course of business. Payments to pre-commencement creditors are often also restricted (whether or not in the ordinary course of business), on the basis that all such pre-commencement creditors should be treated on a *pari passu* basis.

For example, under the Part A1 Moratorium there are various restrictions on the company obtaining credit, granting security, making payments of pre-moratorium debts or disposing of property — see discussion at section 5.4(d) above. In most cases the monitor or court may approve transactions that are otherwise restricted.

Similarity, section 363 of the US Bankruptcy Code, in most cases, allows the debtor company to use, sell or lease property in the ordinary course of business. However

transactions outside of the ordinary course of business require Bankruptcy court approval.[213]

It is notable that such restrictions on transactions by a company subject to a scheme moratorium in Singapore only arise where the court makes an order to that effect (rather than such restrictions applying by default) — see section 5.3(b) above. In the TMA's view this is insufficient protection where there is a general debtor-in-possession moratorium.

Accordingly, the TMA is of the view that should a debtor-in-possession moratorium be adopted it is necessary to ensure there are appropriate restrictions on the transactions that can be entered into the company (particularly those outside the ordinary course of business), unless the company obtains the approval of a court or an independent monitor.

(b) Voidable transactions

If the company in insolvent under section 95A of the Corporations Act, transactions entered into by the company are potentially at risk of being set aside in a subsequent liquidation as voidable transactions under sections 588FE and 588FF (where the other relevant requirements of those provisions are satisfied by a liquidator).

This could create significant difficulties for creditors receiving payments from the company during the moratorium period. The existence of the moratorium could, arguably, mean that the creditor would have "reasonable grounds for suspecting that the company was insolvent at that time", and therefore be unable to rely on the good faith defence under section 588FG to an unfair preference claim.

Such concerns could significantly hamper the company's ability to trade with creditors during this period, and accordingly there would likely need to be an exception from the voidable transaction provisions for payments or other transactions entered into during the moratorium period that were incurred or the disposition is made, directly or indirectly: (i) in the ordinary course of business; or (ii) in connection with the scheme of arrangement; or (iii) with the approval of the court or an independent monitor.[214]

Consideration would also need to be given to the "relation-back day" when a moratorium period precedes a winding up. Would the relation-back day be taken to be the moratorium commencement date, in a similar way to the commencement date of an administration?

We note that many of these issues would appear, in theory, to arise under the Singapore scheme moratorium, but do not appear to have been addressed in that legislation. However as discussed at section 5.3(b) above, we gather that, in practice, voidable transactions are less commonly pursued in Singapore than in Australia.

(c) Treatment of debts incurred during the moratorium period

It will also be necessary to have a regime that provides for the priority payment of any necessary and appropriate debts incurred during the moratorium period. Without clear priority treatment for these debts in any subsequent insolvency process (and the ability for the company to be pay them in the normal course during the moratorium period) the company's customers and suppliers are unlikely to be willing to take any credit risk on the company, and will likely only transact on a "cash-on-delivery" basis or shortened trading terms.

In an administration or receivership this issue is addressed by the personal liability of the administrator or receiver for (among other things) debts incurred by the company for services rendered, goods bought, property leased and (in the case of administrators)

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213 Michael L Bernstein and George W Kuney, '*Bankruptcy in Practice*' (American Bankruptcy Institute, 5th ed, 2015) 248.

214 See, eg, *Insolvency Act 1986* (UK) s 174A; *Bankruptcy Code 1978*, 11 USC §§ 364(a)–(b).

money borrowed during that period.[215] The administrator or receiver in turn has an indemnity out of the assets of the company or security for such liability.[216]

Without an external officeholder, such as an administrator, that is in control of the company and who would be personally liable for the debts incurred,[217] it will likely be necessary to create a separate category of priority claim under sections 433, 561 and 556 of the Corporations Act for appropriately incurred amounts during the moratorium period that have not been paid.

We note that while both the Singapore moratorium (see section 5.3(d) above) and the UK Part A1 Moratorium (see section 5.4(e) above) have some provisions dealing with the priority of certain debts during the respective moratorium periods, neither regime appears to address this issue in a particularly satisfactory manner, and the TMA considers that this would require further consideration in the Australian context.

6.7 Disclosure and transparency

If a broad debtor-in-possession moratorium is to be introduced, the TMA considers it is important that there be appropriate disclosure and transparency as to its status and the financial position of the company.

In a voluntary administration, there are a number of key disclosures to creditors and the public, including:

- upon commencement of the administration, the filing of notices at ASIC that publicly discloses that the company has entered administration;
- the making of a report by the administrator to creditors about the company's business, property, affairs and financial circumstances (pursuant to the *Insolvency Practice Rules (Corporations) 2016* (Cth)); and
- a requirement to set out in every public document (and negotiable instrument) of the company, after the company's name where it first appears, the expression ("administrator appointed").

Consideration should be given to whether similar disclosures would be required where a company was subject to a broad debtor-in-possession style moratorium to ensure that creditors are suitably informed of the company's position and anyone dealing with the company is on notice of the fact that it was subject to a moratorium (and could therefore assess the risks of continuing to deal with the company in that state).

In the case of any reporting to creditors, it would also be necessary to consider:

- what matters would need to be disclosed (including whether this should include financial information, such as balance sheets, receipts and payments and cash flow forecasts, as well as qualitative information on the company's trading performance and plans);
- the timing and frequency of such reporting (including the extent to which any particular documents or information should be filed or disclosed as a condition of accessing the moratorium);

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215 *Corporations Act 2001* (Cth) ss 419, 443A.

216 *Corporations Act 2001* (Cth) ss 443D–443F.

217 We do not think it would be tenable for an officeholder such as a monitor, that did not have the ability to control incurrence of debt by the company, to be personally liable for that debt in the same way as an administrator or receiver.

- who would be responsible for preparing such reports in the absence of an external administrator (including any liability or cost associated with such report, and how they would obtain access to the necessary information); and
- who would obtain access to the reports (for example, would they be publicly filed at ASIC).

In addition, consideration should be given to whether the company must notify a creditor, in writing, of the existence of the moratorium prior to the creditor advancing funds to the company (in a similar manner to the requirement under the Part A1 Moratorium),[218] and the extent to which the absence of an external administrator would require reporting or disclosure beyond that applying in a voluntary administration.

We note that the recently introduced Singapore scheme moratorium has highlighted the tensions around a debtor-in-possession moratorium being granted where there is limited disclosure of key financial information by the company to its creditors, and the negative impact this has on confidence in the both the applicable companies and the Singapore regime more generally — see the discussion at sections 5.3(b) and 5.3(e) above.

The TMA considers that it is important that if Australia is to adopt a general debtor-in-possession moratorium that there be greater disclosure and transparency to creditors built into the system than under the Singapore system.

6.8 Credit market perspective

When considering the introduction of a broad debtor-in-possession moratorium the TMA sees it as important that the Government consider how this would be regarded by the international and domestic finance markets, and the extent to which this could impact the pricing and availability of finance in the Australian market.

This may be less of an immediate concern in the current climate where interest rates are low and financing is readily available. However, caution should be taken in adopting restructuring and insolvency reforms that could be regarded as undermining creditor protections.

In this regard we note the feedback from Singapore based restructuring professionals (see discussion at section 5.3(e) above) who have indicated that Singapore's enhanced scheme moratorium has given rise to some degree of concern among banks and other financiers that there is insufficient oversight and control of companies during this process, and that the moratorium has been used to keep creditors at a distance, rather than to engage them with the process. However, it is difficult to assess how widespread this concern is, and whether it has impacted lending decisions.

6.9 Incentive to address problems early

The TMA is firmly of the view that early intervention is critical to the successful turnaround of distressed businesses.[219]

One potential concern with adopting an "easy access" debtor-in-possession moratorium is that it could encourage distressed companies to delay or "wait and see" rather than grappling with their problems early.

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218 See section 5.4(d) above.

219 Daniel Woodhouse, 'Avoiding Insolvency: Dealing with operational stress & disruptive events', *FTI Consulting* (Web Page, February 2019) <https://ftiinsights.com/avoiding-insolvency/>; United Kingdom Government, *Central Government Guidance on Corporate Financial Distress* (Report, July 2019) 12 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/816631/20190710-Corporate_Financial_Distress.pdf>.

However, it could also be argued that the existence of a debtor-in-possession regime may encourage more companies to enter into a process early given the ability to retain greater control. The outcome in practice is likely to depend on the details of any regime which may be implemented, but it is important to ensure that any regime incentivises the right behaviour by directors and management and encourages companies to face up to their difficulties in a responsible manner.

Successful restructuring and insolvency outcomes require a degree of balance between having sufficient pressure on a debtor to address its issues and engage with its creditors, whilst at the same time providing directors and companies some breathing space to develop and implement a restructuring and turnaround.

Arguably, Australia has this balance more or less right at this stage, particularly following the introduction of the safe harbour regime, which has ameliorated some of the pressure of directors' personal liability where the company may be trading whilst insolvent, provided they actively pursue one or more courses of action that are reasonably likely to lead to a better outcome for the company than the appointment of an administrator or liquidator to the company.

Care should be taken when introducing a debtor-in-possession regime to ensure that companies and directors are still incentivised to act early.

6.10 Disruption and damage to the business

As discussed at sections 4.4 and 6.3(j) above, a key objective of the "out-of-court" restructuring process (of which creditors' schemes of arrangement sometimes form a part) is generally to avoid damage to the business itself, and therefore restrict restructuring discussions (and ultimately any debt compromise) to the financial creditors.

We are concerned that introducing a broad automatic moratorium into the creditors' scheme of arrangement process could actually cause damage to the value of the company's business. The imposition of a moratorium on any claims against the company would presumably be public knowledge (including for the reasons set out at section 6.7 above), and would indicate to the company's customers and suppliers, and the broader market, that the company was in financial difficulty and unable to pay its debts (otherwise presumably the moratorium would not be required). Furthermore, for the reasons described in sections 6.5–6.6 above, we assume that any broad moratorium of this kind would need to be accompanied by various restrictions on the company's activities, causing additional disruption and uncertainty for third parties.

Where such a moratorium is announced before any restructuring has been agreed there would be the further problem that there would be no positive message to the creditors indicating that a solution is in the process of being delivered, or that the necessary creditor support to restructure the company and avoid an insolvency has been obtained.

Accordingly, the TMA considers any announcement of a broad moratorium in respect of all creditors of the company would likely have a similar impact on suppliers, customers and other market participants as if the company had entered voluntary administration.

For these reasons, we expect that even if an automatic moratorium of this sort was available to companies, in many cases a company and its financiers would prefer not to utilise it in order to avoid the resultant negative impact on the business.

Accordingly, the TMA is of the view that should the Government be minded to introduce a broad automatic moratorium of the sort described in the Consultation Paper, such a moratorium should be optional rather than mandatory. It would also be preferable to be able to limit the scope of any such moratorium to the creditors' proposed to be bound by the creditors' scheme of arrangement, rather than all creditors of the company.

6.11 A debtor-in-possession moratorium should not be "tied" to creditors' schemes of arrangement

(a) Why tie a moratorium to creditors' schemes of arrangement?

Given the small number of creditors' schemes of arrangement carried out in Australia (as discussed at section 4.3 above),[220] we do not consider that it makes sense to introduce a new debtor-in-possession style regime that only applies to companies looking to undertake a creditors' scheme of arrangement procedure. This would be designing a complicated process for a very small subset of companies. Furthermore, as discussed at section 6.3 above, this would be creating a new process where it does not appear either necessary or helpful.

If the Government's aim is to increase restructuring and turnaround through the introduction of a debtor-in-possession moratorium then the TMA considers it would be more fruitful to consider the introduction of a more general "standalone" moratorium procedure (rather than a moratorium tied to creditors' schemes of arrangement), as discussed further in the following section.

(b) Restructuring vs scheme moratorium and timing issues

One of the fundamental difficulties with tying the moratorium to the creditors' scheme of arrangement is that a creditors' scheme of arrangement only begins formally when the first application is made to the court to convene the meeting of creditors (see section 4.2(b) above).

However, as discussed at section 4.5 above, in the restructuring context, a creditors' scheme of arrangement is really just the implementation process that comes at the end of a long process of engagement and negotiation between a company and relevant groups of its financial creditors. This restructuring process is a fluid, and largely unstructured, process during which it may not be clear what form an ultimate restructuring might take, or whether a creditors' scheme of arrangement will be adopted or required at all (let alone what the terms of it would be).

In this context it is difficult to understand what the "starting point" should be for the availability of a moratorium intended in connection with a creditors' scheme of arrangement. As discussed at section 4.7 above, the section 411(16) order is available once a scheme has been "proposed". However, as discussed at section 6.2 above, it is apparent that the Consultation Paper is seeking the moratorium to be available at an earlier time than this.

In Singapore, the scheme moratorium is available where a company "proposes, or intends to propose" a scheme of arrangement. This introduces a subjective element, and significant uncertainty as to how developed, specific, viable or certain the "intention" must be in order to qualify for the moratorium.

In the TMA's view, as a manner of substance, there are really two key stages to consider:

- the **restructuring negotiation period**, where the precise form of restructuring has not yet been agreed, and the position remains fluid; and
- the **restructuring implementation period**, once sufficient stakeholders have agreed on the material terms of restructuring deal, and all that remains is to finalise aspects of the long form documentation and, where a formal statutory process such as a creditors' scheme of arrangement is involved, carry out such process.

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220 Commonwealth Treasury, *Helping Companies Restructure by Improving Schemes of Arrangement* (Consultation Paper, 2 August 2021) 5.

The current availability period of section 411(16), which allows the court to restrain further proceedings when a scheme is "proposed", roughly correlates to this latter period where the implementation of the restructuring is to be done via a scheme of arrangement.

To the extent that the Government considers it desirable for a moratorium to be available earlier, ie during the restructuring negotiation period, there seems to be little sense in tying the moratorium requirement to a creditors' scheme of arrangement. In reality during this period the use of a creditors' scheme of arrangement will be uncertain, and ultimately not particularly relevant to the substantive question, which is whether there should be a debtor-in-possession moratorium available to companies while they seek to negotiate a restructuring. Requiring a company to have an intention to propose a scheme, or otherwise requiring a link between the restructuring negotiations and a scheme of arrangement appears to arbitrarily limit availability of the moratorium to only certain circumstances, and to encourage companies to adopt a particular implementation tool simply to avail themselves of this protection.

The problematic nature of this approach is further compounded to the extent that the company ultimately seeks to carry out some other form of restructuring or sale transaction that does not require a scheme of arrangement. If the moratorium was tied to an intention to carry out a scheme of arrangement, the moratorium protection would presumably fall away at the point at which the company had decided or sought to implement the restructure via another pathway. However, the company may still require the protection of the moratorium at that time, and arguably it would be more compelling for such protection to be granted once the implementation stage was reached (given the shorter remaining timeframe and greater certainty of outcome).

This practical difficulty has emerged in a number of cases in Singapore where a scheme moratorium has been sought and obtained on the basis that the company is intended to propose a creditors' scheme of arrangement, but no such scheme ever eventuates (see, for example, the cases mentioned at section 5.3(e) above).

(c) A "standalone" debtor-in-possession moratorium

If the Government is minded to move Australia in the direction of a debtor-in-possession restructuring regime (in contrast to the current "external administration" model of voluntary administration), then the TMA believes this significant step should be considered holistically, rather than just in the context of creditors' schemes of arrangement.

Ideally any debtor-in-possession regime would be flexible enough to apply to a wide range of distressed Australian companies, of a range of sizes and problems, with access to a number of restructuring tools or solutions depending on what is appropriate.

We have labelled this more flexible form of debtor in possession regime a "standalone" moratorium to emphasise that it would not require a creditors' scheme of arrangement to be contemplated or proposed, but instead allow a company to file for the moratorium on a standalone basis and then work out what the best form of restructuring would be.

Under this alternative approach, the standalone moratorium would provide a limited and defined period of breathing space, where the directors and management remain in control of the business, subject to suitable oversight, disclosures and controls. The company could use this period to engage with its creditors and negotiate an appropriate restructuring or sale of the business, depending on what was appropriate in the circumstances.

Under a standalone moratorium the company could potentially "exit" from the process in a number of ways, including:

- a sale of the business;
- a restructuring through a DOCA;

- a restructuring through a creditors' scheme of arrangement;
- a liquidation (should the restructuring be unsuccessful); or
- potentially other options (such as a capital raise).

The TMA is of the view that a standalone moratorium along these lines would offer significantly more flexibility than a moratorium procedure tied to schemes of arrangement, allowing it to be used by a much broader range of companies.

The TMA considers that there may well be good reasons for Australia to explore and develop a debtor-in-possession restructuring regime.[221] As noted by the American Bankruptcy Institute:

> Proponents of the debtor in possession model highlight the knowledge and expertise of the debtor's prepetition directors, officers, or similar managing persons concerning the debtor's business and financial affairs. The ability of the debtor in possession to continue to operate through its prepetition management team facilitates the company's seamless transition into chapter 11 and allows the debtor to avoid the additional time, cost, and resulting inefficiencies of bringing in an outsider who is not familiar with the debtor's business specifically or the debtor's industry generally. The prepetition management team may also have industry relationships or "know-how" that would benefit the debtor's restructuring efforts.[222]

There is clearly a growing movement internationally for greater adoption of debtor-in-possession approaches to restructuring, as can be demonstrated by introduction of the Part A1 Moratorium in the UK and the European Restructuring Directive.

However, developing such a regime for use in Australia would require a significant amount of work, as it would be necessary to, among other things, address the issues discussed at sections 6.4 – 6.10 above.

6.12 Holistic review of Australia's insolvency and restructuring framework is required

In our view the proposed introduction of a debtor-in-possession automatic moratorium raises significant and fundamental questions that go to the core of Australia's restructuring and insolvency law framework.

Adopting such a process would involve a re-evaluation of the approach and principles set out in the Harmer Report, upon which Australia's current restructuring and insolvency framework is built. Before embarking on such a course, we therefore think that proper consideration should be given to whether a debtor-in-possession regime of this type would be appropriate or beneficial for the Australian market and whether it would actually lead to a material improvement in outcomes for Australian companies and their stakeholders.

This is particularly important given that debtor-in-possession models have been considered previously in Australia, including by CAMAC and the Parliamentary Joint Committee on Corporations and Financial Services, both of which rejected a Chapter 11 type approach for Australia.[223] Much has changed since those reports, including the development of alternative debtor-in-possession models to Chapter 11 (such as

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221 See for example the discussion in Gerard McCormack, *The European Restructuring Directive* (Edward Elgar Publishing, 2021) [3.46]–[3.55].

222 American Bankruptcy Institute, *Final Report of the Commission to Study The Reform of Chapter 11* (Final Report, 2014) 22.

223 Corporations and Markets Advisory Committee, *Rehabilitating large and complex enterprises in financial difficulties* (Final Report, 7 October 2004) 5–6 [1.5]; Joint Committee on Corporations and Financial Services, Parliament of Australia, *Corporate Insolvency Laws: a Stocktake* (Report, June 2004) xxi.

contained in the Part A1 Moratorium and the European Restructuring Directive) and changing attitudes more generally, both in Australia and internationally to corporate rescue and restructuring. However it must also be acknowledged that there were good reasons for those previous reviews not to recommend a debtor-in-possession process for Australia.

Accordingly, the TMA is of the view that Australia should only consider adopting a broad debtor-in-possession moratorium, of the sort outlined in the Consultation Paper, following a holistic and thorough review of Australia's restructuring and insolvency framework by one or more appropriate experts.[224]

We consider a review of this sort long overdue, and something that should be prioritised over piecemeal reform.

6.13 Adjustments to section 411(16)

Notwithstanding the comments in the previous parts of this section 6, the TMA considers that there is some merit in making some relatively modest adjustments to the existing section 411(16). Such modifications would be to clarify its purpose, the scope of its application, and to address some minor gaps in its coverage in the context of Australian restructurings.

We note that the precise scope of section 411(16) is unclear, and it would be helpful for the legislation to specify (to the extent relevant):

- the types of actions that can be stayed by section 411(16) — is it just court proceedings, or can it extend to preventing insolvency processes, security enforcement or accelerating (or demanding payment of) debt obligations;
- who the stay may apply to — is it just those creditors who are subject to the potential scheme, or can it be other creditors even if they are not proposed to be subjected to it;
- whether there should be an 'ipso facto' stay available in respect of orders made under section 411(16) (it being noted that the current ipso facto stay for schemes of arrangement, that is provided for under section 415D of the Corporations Act, does not appear to extend to stay rights that are enforced by reason of an order made under section 411(16));[225] and
- what matters the court must consider when determining whether to grant the stay — for example should the court be required to consider the prejudice to creditors, whether a stay is reasonably necessary to achieve the purpose of the scheme or whether the scheme is actually viable and is likely to be passed by creditors?

In particular, we think consideration should be given to aligning the scope and purpose of section 411(16) to better reflect modern "out-of-court" restructuring practice. In this regard, it is helpful to consider:

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224 A similar point was made by Jason Harris, 'Restructuring nirvana? Chapter 11 bankruptcy and Australian insolvency reform' (2015) 16(3) *Insolvency Law Bulletin* 42.

225 In this regard we note that given that many "out-of-court" restructurings are seeking to prevent disruption or damage to the business, including by way of contract terminations, such an ipso facto stay would appear beneficial. However, it is also noted that the current ipso facto stay regime is not achieving it stated purpose given the significant number of exceptions, and the fact that it does not include a rejection, assumption or assignment regime such as contained in Chapter 11: see generally in this regard Kathryn Sutherland-Smith "A Trans-Pacific Tale of Carrots and Sticks: Lessons for Australia from the United States' Experience of the Ipso Facto Stay" (2018) 26 *Insolvency Law Journal* 3. However, it should also be noted that such tools allowing the debtor to "pick and choose" are not inappropriate where the company is only undergoing a creditors' scheme of arrangement, rather than a more all-encompassing restructuring and insolvency procedure.

- where a company might wish to prevent creditor enforcement in connection with a restructuring to be implemented via a creditors' scheme of arrangement;
- whether it is appropriate for such action to be restricted in those circumstances;
- the extent to which such protection against enforcement already exists or there are gaps; and
- the possible adjustments that could be made to section 411(16) to address those gaps.

The following table sets out such considerations, and provides some possible adjustments that could be made to section 411(16) to better cater for these circumstances.

Dissenting group that stay would potentially protect against	Appropriate approach	How is the risk currently addressed?	Is there a gap in the current regime?	Possible amendment to section 411(16)
A dissenting financier group representing 25% or more of the class of scheme creditors (**Blocking Group**) seeks to: • accelerate debt; • enforce security; • wind up the company; or • sue for due debt, either before or after a scheme is "proposed"	Scheme will not be passed without consent of (at least some of) Blocking Group, therefore no benefit in moratorium	No risk	No gap	No amendment needed
A dissenting financier group representing less than 25% of the class of scheme creditors (**Minority Group**) seeks to: • accelerate debt; or • enforce security, after scheme is "proposed"	Minority Group should be able to be restrained from accelerating or enforcing security.	Collective enforcement provisions in the finance documents will generally require majority lender resolution to accelerate or security enforcement, therefore Minority Group will not be able to accelerate or enforce without broader support.	Gap only arises in respect of acceleration rights where there are multiple bilateral loans with no collective acceleration provisions. This is rare and generally only occurs for unsecured investment grade lending (eg Arrium).	Consider broadening section 411(16) so that a court can elect to restrain: • legal proceedings (including winding up proceedings); • acceleration rights; • security enforcement rights, of proposed scheme creditors where a scheme has been proposed.
A Minority Group seeks to: • wind up the company; or • sue for due debt,	Minority Group should be able to be restrained from winding up company or suing for payments of debt.	Collective enforcement provisions in the finance documents may not prevent winding up company or suing	No gap	No amendment needed

Dissenting group that stay would potentially protect against	Appropriate approach	How is the risk currently addressed?	Is there a gap in the current regime?	Possible amendment to section 411(16)
after scheme is "proposed"		for payments of debt. However, section 411(16) stay available.		
A Minority Group seeks to: • accelerate debt; • enforce security; • wind up the company; or • sue for due debt, before scheme is "proposed"	Arguably this should depend on what creditors have agreed in their finance documents. If action is not restrained by finance documents it should limited, and only available where the scheme is well advanced, with reasonable creditor support and good prospects of success .	Collective enforcement provisions in the finance documents will generally require majority lender resolution to accelerate or security enforcement, therefore Minority Group will not be able to accelerate or enforce without broader support. Collective enforcement provisions in the finance documents may not prevent winding up company or suing for payments of debt.	Possible gap in respect of: • acceleration rights where there are multiple bilateral loans with no collective acceleration provision; • where collective enforcement provisions in the finance documents do not prevent winding up company or suing for payments of debt; or • where issue arises before scheme is proposed.	In addition to change noted above, consider broadening where section 411(16) is available to stay proposed scheme creditors (only) at a slightly earlier point in time where there is a "Viable Proposed Scheme" (see footnote).[226]
One or more senior ranking finance creditors not subject to the scheme seek to: • accelerate debt; • enforce security; • wind up the company; or • sue for due debt,	Senior ranking finance creditors should not be restrained unless: • they have agreed restraints under the finance documents; or • they will be crammed	Generally there will be limited restraints on senior ranking financiers in the documents. In some cases section 411(16) may be available.	No (unless cross-class cram down enacted).	To be considered if cross-class cram down enacted.

226 The concept of a "Viable Proposed Scheme" would need to be developed, but we have in mind the existence of a creditors' scheme of arrangement in respect of which: (i) the key commercial terms have been agreed in principle by a significant number of each of the proposed classes of scheme creditors (other than crammed down classes); (ii) there are reasonable prospects that the scheme will be passed by the scheme creditors at the creditors' scheme meeting; and (iii) the company has sufficient funding to trade in the normal course until the scheme was implemented. The Court would otherwise need to be satisfied that it was appropriate to exercise its discretion to give a stay. It may be in practice that this does not provide a significantly greater benefit from the existing "proposed" test. However we find it difficult to see how a court could justify restraining the rights of creditors in respect of a possible creditors' scheme of arrangement if these conditions were not satisfied.

Dissenting group that stay would potentially protect against	Appropriate approach	How is the risk currently addressed?	Is there a gap in the current regime?	Possible amendment to section 411(16)
either before or after a scheme is "proposed"	down under the scheme.			
One or more junior ranking finance creditors not subject to the scheme seek to: • accelerate debt; • enforce security; • wind up the company; or • sue for due debt, either before or after a scheme is "proposed"	Junior ranking finance creditors should not be restrained unless: • they have agreed restraints under the finance documents; or • they will be crammed down under the scheme.	Subordination provisions in intercreditor documents will generally provide a standstill on any acceleration, enforcement, winding up or legal action by junior creditors on their debt for a period of time to allow restructuring to occur. In some cases section 411(16) may be available.	No (unless cross-class cram down enacted).	To be considered if cross-class cram down enacted.
One or more trade creditors not subject to the scheme seek to: • wind up the company; or • sue for due debt, either before or after a scheme is "proposed"	Trade creditors should not be restrained unless they are actually subject to the scheme (which is rare). Unlikely to be a practical problem.	In some cases section 411(16) may be available. Ipso facto restrictions on creditors seeking to terminate contracts based on company's financial position where a scheme has been proposed.	Ipso facto protections could be strengthened to cover the making of orders under section 411(16).	Potential for s 411(16) orders to be extended to encompass greater ipso facto protections. To be considered further if cross-class cram down enacted.
Shareholders seek to change board to block scheme before or after a scheme is "proposed" to prevent scheme that disenfranchises equity.	Unclear. There is a stronger argument for this if a cross-class cram down in respect of shareholders is introduced.	In some circumstances it may be possible to block a change of directors through appointment of an administrator or exercise of share security rights.	No (unless cross-class cram down enacted).	To be considered if cross-class cram down enacted.

7 Cross-class cram downs for creditors' schemes of arrangement

7.1 Overview

In our view Australia should introduce a "cross-class cram down" for creditors' schemes of arrangement modelled on the recently introduced UK "restructuring plan", as provided for under Part 26A of the UK Companies Act.

Under existing law, Australian creditors' schemes of arrangements only allow intra-class cram downs — ie the ability to bind dissenting minorities within the same creditor class. Generally, this means that senior lenders are unable to bind junior creditors or shareholders to a creditors' scheme of arrangement, even where those junior creditors or shareholders are "underwater", and cannot expect to receive anything upon the insolvency of the company. This allows these parties to extract "consent payments" as the cost of buying the voluntary assistance of these classes, reducing recoveries to senior creditors (see the discussion at section 4.4 generally).

A cross-class cram down mechanism would allow financial restructurings of distressed companies to be undertaken more efficiently. It would allow claims of junior creditors and shareholders that are "underwater" to be extinguished without their consent. This in turn would avoid the necessity of "consent payments" or other value being siphoned off to parties who no longer have any real economic interest in the business.

This would be consistent with the approach already taken under DOCAs, where section 444GA can be used to compulsorily transfer shares that have no economic value. It would also be consistent with the existing power to bind "subordinate claims" to a creditors' scheme of arrangement without a vote of that class.

The UK's recently introduced Part 26A restructuring plan provides the best model for Australia to follow when enacting a cross-class cram down. Whilst still relatively new and still being explored, the UK cross-class cram down has already been used successfully in a number of major restructurings. It generally appears to have been well received by the European market to date. We also consider that closely following the UK market will allow Australia to benefit from UK experience and case law as one of the world's leading restructuring jurisdictions, and ensure that Australia's restructuring framework will be familiar to international investors.

The TMA believes that an efficient, predictable and fair cross-class cram down will result in better restructuring outcomes. This will benefit not only the lenders directly participating in the restructuring, which are often secondary market distressed fund investors, but also primary lenders who can expect to receive better pricing when they sell their debt as a result.

7.2 Class voting under existing creditors' schemes of arrangement

Under existing Australian law a company may propose a scheme or arrangement in respect of one or more classes of its creditors.

For the scheme of arrangement to be approved, creditors representing 75% by value and a majority in number of each class (attending the meeting and voting) must vote in favour of the scheme. If any class votes against the scheme, then the scheme will fail.

Therefore the existing scheme framework only allows dissenting minority creditors to be bound where they form part of the same class of creditor as a requisite majority of creditors. This is sometimes referred to as a "class cram down" or "intra-class cram down"

as it allows minority creditors within a class to be crammed down and bound to an arrangement to which the requisite majority agree.

Class formation is therefore critical. Creditors may only be placed in the same class where their "rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest".[227] This can be a difficult analysis in practice, and there is significant case law and debate as to what degree of difference in creditor rights is sufficient to require creditors to be placed in a different class.[228]

However, it is generally accepted that creditors with different priority treatment, and therefore different expected return, in an insolvency of the scheme company should be placed in different classes, as their rights are so different that they cannot sensibly vote together.[229]

7.3 Inability to bind other dissenting creditor classes under existing creditors' schemes of arrangement

Accordingly, whilst the analysis is always fact dependent, typically senior lenders and junior lenders would be placed in different classes under a creditors' scheme of arrangement. Where this occurs, a vote by the requisite majority of the senior lender class in favour of the scheme would be unable to bind the class of junior lenders (and vice versa).

This inability to bind another class to the terms of the scheme likely applies even where that other class is considered "out of the money" or "underwater". For example, where the company is financially distressed and the junior lenders are not expected to recover anything upon the company's entry into formal insolvency, the class of junior lenders would still not be bound by the terms of the scheme unless the requisite majority of that class voted in favour.[230]

This can give junior classes of creditors that otherwise have no economic interest in the company "hold out rights" — their consent is needed to extinguish their debt under a scheme of arrangement, and therefore they can extract some payment or retention of some interest in the restructured company as the price of providing that consent. The alternative for the senior creditors (who are in the money) would typically be to seek to enforce their priority position through a receivership or administration of the company. However in many cases a formal insolvency of the company would risk significant destruction in value of the company's business and therefore lower recoveries for the creditors. The senior creditors are therefore forced to make consent payments to junior creditors as the lesser of two evils.

It can be noted that in the UK a "work around" has been developed to address this inability to cram down junior financial creditors. The process has involved "twinning" the

227 *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573, 583.

228 The legal test for class composition is examined in more detail in Jason Harris, 'Class Warfare in Debt Restructuring: Does Australia Need Cross-Class Cram Down for Creditors' Schemes of Arrangement?' (2017) 36(1) *University of Queensland Law Journal* 73, 85-89 and in T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks* (University of Sydney Press, 3rd ed, 2013) [6.2].

229 *Re Brian Cassidy Electrical Industries Pty Ltd* (1984) 9 ACLR 140, 143; *Re Healthscope Ltd* (2019) 139 ACSR 608, [118]; *Re APCOA Parking Holdings GmbH (No 2)* [2014] EWHC 3849 (Ch), [48], or differing security or intercreditor rankings see for example *Re PrimaCom* [2011] EWHC 3746 (Ch); *Re Tiger Resources Ltd* (2019) ACSR 203, [85]–[100]. See also Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (Thomson Reuters, 2nd ed, 2017), 5-025–5-028.

230 Whilst there is case law supporting the ability to approve a scheme notwithstanding an impact on the interests of a class of creditors with no economic interest in the company *Re Tea Corporation Ltd* [1904] 1 Ch 12; *Re Opes Prime Stockbroking Ltd (No 1)* (2009) 73 ACSR 385, [76], impacting upon a creditor's rights is not equivalent to being bound by the terms of the scheme.

creditors' scheme of arrangement with a pre-packaged administration sale of the business and assets (or a holding company) to a new company, "stranding" creditors in the dissenting class in a shell company with no assets.[231] A pre-packaged administration mitigates some of the value destruction that might otherwise occur in a formal insolvency process by virtue of the fact that the sale occurs virtually instantaneously on appointment of the administrators, and therefore, from the perspective of trade creditors and other counterparties of the business, the insolvency process is (in practical terms, and as far as it relates to the ongoing business) over before they realise it has begun. This approach has not developed in the Australian market however, as the Australian market and legal framework has been less receptive to the concept of pre-packaged administration (or receivership) sales.[232] It is also important to note that the UK "work around" is imperfect, as even a pre-packaged administration sale can involve cost and disruption, especially where a business and asset sale is required (as opposed to a share sale at a holding company level in the corporate group).

The inability to bind other classes of "out of the money" financial creditor is a particular issue for larger corporations with complex capital structures involving multiple "layers" of debt with differing contractually agreed priorities. Such financing structures have been on the rise globally, including in Australia, over the last couple of decades, driven by the increased availability of cheap debt (see discussion at section 4.6 above).

This ability for "out of the money" creditors to extract value through a restructuring has been described as "rent-seeking" behaviour, which introduces inefficiencies, costs and delay into a creditors' scheme. [233] Importantly, it reduces recoveries for senior ranking creditors who would otherwise be entitled to recover a larger portion of their debt. Such senior creditors are typically entitled to this recovery by virtue of the terms of the debt and security they have negotiated, and therefore the extraction of value by "out of the money" creditors undermines the effectiveness of the credit environment.

7.4 Inability to bind shareholders under existing creditors' schemes of arrangement

Similarly, the existing creditors' scheme of arrangement mechanism contains no ability to bind shareholders.

Typically a restructuring by way of creditors' scheme of arrangement will involve a debt for equity swap, whereby the creditors agree to extinguish some or all of their debt in exchange for some or all of the shares of the restructured company. This is an effective tool to "right size" the company's balance sheet.

A creditor can be granted shares in a company either by a transfer of existing shares from current shareholders to the creditor, or by issuing new shares in the company. Both of these routes typically require shareholder consent.

There is no power to compel a shareholder to transfer his or her shares to another person as part of a creditors' scheme of arrangement — the shareholders are not party to the scheme. Whilst a shareholder could be compelled to do so by way of a members'

231 Sarah Paterson, "Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform" (2018) 3 *European Company and Financial Law Review* 472, 485.

232 There are a number of reasons for this, as has been surveyed in a number of articles including: see for example Hal Lloyd, Maria O'Brien and Janna Robertson 'Pre-packaged transactions in administration — strategy and application' (2009) 9(7) *Insolvency Law Bulletin* 142; David Brown 'Unpacking the pre-pack' (2009) 9(10) *Insolvency Law Bulletin* 164; Emanuel Poulos and Ayowande A McCunn 'Pre-pack transactions in Australia' (2011) 19 *Insolvency Law Journal* 235, 1; Mark Wellard and Peter Walton, 'A Comparative Analysis of Anglo–Australian Pre–Packs: can the means be made to justify the ends?' (2012) 21(3) *International Insolvency Review* 143; Alicia Salvo 'The UK's Graham Review into pre-packs — is Australia missing out?' (2014) 15(9) *Insolvency Law Bulletin* 140.

233 Jason Harris, 'Class Warfare in Debt Restructuring: Does Australia Need Cross-class Cram Down for Creditors' Schemes of Arrangement?' (2017) 36(1) *University of Queensland Law Journal* 73, 74.

scheme of arrangement, this would require the requisite majority of shareholders to vote in favour of such an arrangement.

Similarly, listed companies generally require shareholder approval for the issuance of shares exceeding 15% of the company's share capital in a 12 month period under the Australian Securities Exchange (**ASX**) Listing Rules 7.1 and 7.1A.

Accordingly, shareholders also frequently have "hold out rights" and can seek to retain ownership of some percentage of the company as the price of approving the issuance of shares to creditors in exchange for their debt. Similar economic criticisms could be levelled at shareholders retaining value in a restructured company where the equity is underwater, as those applicable to junior financial creditors that are out of the money.

From a coordination standpoint, the challenge is particularly acute where the shares are widely held, such as a company that is listed on the ASX. In those cases obtaining the requisite consent of a wide range of shareholders with varying levels of sophistication and differing attitudes to the company and its restructuring is extremely challenging, and therefore may require paying away increased value to shareholders to secure their consent.

7.5 The lack of a shareholder cram down as part of creditors' schemes of arrangement is incongruous with existing Australian law

The lack of a shareholder cram down is particularly anomalous given other cram down powers currently existing under Australian law.

There is a power under section 411(5A) of the Corporations Act allowing a creditors' scheme of arrangement to bind "subordinate claims" of shareholders without those creditors being included as a formal class of creditors under the scheme. Subordinate claims for these purposes are claims owed by the company to a person in the person's capacity as a member of the company (whether by way of dividends, profits or otherwise) or any other claim that arises from buying, holding or selling or otherwise dealing in shares in the company.[234] Importantly, subordinate claims will generally encompass shareholder claims for losses suffered as a result of a company breaching its continuous disclosure obligations – a category of liability that has become more common in recent years in respect of financially distressed listed companies. It should be noted that subordinate claims still rank ahead of shareholders upon a liquidation.[235] It is therefore incongruous that the Corporations Act allows subordinate claims of shareholders to be extinguished without their consent as part of a creditors' scheme of arrangement, but does not have a corresponding power to divest shareholders of their ongoing interest in the company as shareholders, despite those shares ranking behind the subordinate claims in a liquidation.

In addition, the ability to cram down shareholders already exists in Australia in the context of DOCAs as part of the voluntary administration process. Under section 444GA of the Corporations Act, the administrator of a DOCA may transfer the shares in the company if the administrator has obtained either the written consent of the owners of the shares or the leave of the court. In the latter case, the court may make such an order where it is satisfied the transfer would not unfairly prejudice the interests of members of the company.[236] This power has been used in numerous cases, allowing restructurings to occur under DOCAs where the company's shares are compulsorily transferred from

234 *Corporations Act 2001* (Cth), s 563A.

235 *Sons of Gwalia Ltd v Margaretic* [2005] FCA 1305, [45]. Any surplus following payment of creditor claims is paid under section 501 of the *Corporations Act 2001* (Cth) in a voluntary winding up, or with the special leave of the court in a compulsory winding up.

236 *Corporations Act 2001* (Cth), s 444GA(3).

existing shareholders to creditors or third party purchasers. The courts have been satisfied that shareholders are not unfairly prejudiced where the courts are satisfied that there is no residual equity for shareholders remaining in the company.[237]

It is also notable that, in the context of creditors' schemes of arrangement, the courts have already indicated that, if they are satisfied that subordinated debt holders or shareholders have no real economic interest in the scheme company, they are not entitled to be included as a class under the scheme, or to have a vote on the outcome of a creditors' scheme.[238] However, a scheme cannot modify the rights of creditors or shareholders that are not party to the scheme (other than subordinate creditors, as mentioned above). Accordingly, the inability to extinguish the rights of persons with no economic interest in the company has meant that, although at the time of the scheme such rights are economically worthless, the rights have had to remain in place and will therefore be able to partake in the benefit of the restructured company. Their previously worthless rights will regain economic value by virtue of the extinguishment of other claims. Whilst there are potential methods of structuring around this issue in some cases (eg via the transfer of assets out of the group and into a new group), this comes at an economic cost.

The TMA sees no reason not to extend a power equivalent to section 444GA to also apply in respect of creditors' schemes of arrangement. Furthermore, we consider that the same legal mechanics, holder protections and legal "test" should apply both to binding subordinate creditors and shareholders, given the economic similarity of these claims and the likely overlap in the holders of these claims and instruments. Ideally such a power would be incorporated into creditors' schemes of arrangement through the introduction of a holistic cross-class cram down mechanic, as discussed further below at 7.7. However, in the absence of such a step we still consider aligning the cram down of subordinate creditors and shareholders in a creditors' scheme of arrangement to the approach taken under section 444GA to be a valuable amendment to the existing legislative regime.

7.6 Introduction of a cross-class cram down for creditors' schemes of arrangement

The issues discussed in the previous sections could be addressed by introducing a cross-class cram down feature in respect of Australian creditors' schemes of arrangement.

Such a cross-class cram down would need to operate to bind dissenting classes of both creditors and shareholders, provided the relevant criteria were satisfied.

Cross-class cram down mechanics have been adopted in a number of foreign jurisdictions, including, in the case of creditors' schemes of arrangement, the recently introduced mechanisms in the UK and Singapore. Both of these jurisdictions have drawn to some extent on (but also departed from) the cross-class cram down mechanics available under Chapter 11 of the US Bankruptcy Code as part of a plan of reorganisation.[239]

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237 *Weaver v Noble Resources Ltd* [2010] WASC 182, [72]–[79]; *Re Mirabela Nickel Ltd (subject to deed of company arrangement)* [2014] NSWSC 836, [42].

238 See the discussion in T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks* (University of Sydney Press, 3rd ed, 2013) 136–41 [4.3.7(d)], 517–20 [9.11.1], and, in particular, the cases that the authors cite.

239 Insolvency Law Review Committee, *Final Report* (Report, 2013) Recommendation 7.11 <https://www.mlaw.gov.sg/files/news/announcements/2013/10/ReportoftheInsolvencyLawReviewCommittee.pdf>; Department for Business, Energy & Industrial Strategy, Insolvency and Corporate Governance: Government response (Response, 26 August 2018) [5.157].

7.7 Which model of cross-class cram down?

The newly introduced "restructuring plan" contained in Part 26A of the UK Companies Act is the best starting point to model any Australian cross-class cram down. We discuss the UK's restructuring plan in more detail at section 5.4(g) above.

As noted at section 5.4(g) above, the UK restructuring plan is based upon the existing UK creditors' scheme of arrangement provisions with some key modifications including, most notably for these purposes, the incorporation of a cross-class cram down mechanic. The restructuring plan has been introduced alongside the existing scheme of arrangement provisions in Part 26 of the UK Companies Act that have been retained. This reflects an acknowledgement that not all creditors' schemes of arrangement are used for restructurings that require cross-class cram downs, and the existing scheme of arrangement provisions provide for both creditors' and members' schemes of arrangement. This separation into a new "restructuring plan" regime to operate alongside existing schemes of arrangement is a helpful approach, which allows the new procedure to be adapted to more specifically cater for restructuring usage.

We consider the UK restructuring plan to be the preferable cross-class cram down model to adopt in Australia for a number of reasons:

- **Similarity of UK and Australian schemes**: The UK creditors' schemes of arrangement (and therefore the new restructuring plan) are quite similar to Australian schemes of arrangement (and they have been used in similar ways). Adopting the UK restructuring plan model would therefore be relatively easy to accommodate into the existing Australian legislative framework;
- **Successful operation and case law**: The UK restructuring plan has already had significant usage in its short period in operation, and in broad terms appears to be operating successfully. There is already a reasonable body of UK case law providing guidance and certainty as to the principles behind the restructuring plan;
- **Sophistication and global acceptance of UK restructuring market**: The UK continues to be a global leader in restructuring, with many companies across Europe and globally choosing to use UK processes to carry out their restructurings. The UK has a deep bench of experienced professionals and judges ensuring a sophisticated and well developed restructuring landscape. By aligning Australia's laws to those in the UK, Australia will be able to benefit from UK developments and insights, and international creditors are likely to be more comfortable and familiar with an Australian regime closely modelled on it;
- **Familiarity of key cram down test**: The key test to be satisfied under the UK cross-class cram down is whether, if the restructuring plan is sanctioned by the court, would any members of the dissenting class be any worse off than they would be in the event of the relevant alternative?[240] This exercise is similar to the exercise already familiar to Australian practitioners and judges of identifying the appropriate comparator for class purposes in the context of a creditors' scheme of arrangement, or determining whether a creditor has been unfairly prejudiced under a DOCA. It should therefore be relatively easy for the Australian market to understand and apply this construct and benefit from existing Australian, as well as English, case law;[241] and

240 *Companies Act 2006* (UK) s 901G(3).

241 See *Re DeepOcean I UK Limited* [2021] EWHC 138 (Ch), [29]–[30] and *Re Virgin Active Holdings Limited* [2021] EWHC 1246 (Ch), [108] where these observations were made and affirmed by Justices Trower and Snowden, respectively, in respect of the similarity in the context of the UK creditors' scheme of arrangement and company voluntary arrangement procedures.

- **Simplicity**: The UK model and related legislation is relatively simple, and easy to understand.

In contrast, the TMA is of the view that the Singapore cross-class cram down is not a suitable model for the following reasons:

- **No successful operation or case law**: To our knowledge there has been no successful use of the Singapore cross-class cram down to date. Accordingly there is no helpful case law or experience that can be drawn upon from the Singapore market;[242]
- **No shareholder cram down**: The Singapore cross-class cram down does not have a shareholder cram down — it only allows cram down of creditor classes. It therefore fails to achieve one of the key goals of a cross-class cram down in a restructuring context;
- **Complexity of concepts**: The Singapore cross-class cram down provision is quite complex, drawing upon provisions and terminology from Chapter 11 of the US Bankruptcy Code. It is not clear yet how appropriate or necessary those concepts are in the different context of a creditors' scheme, or how these United States concepts will be interpreted in Singapore. In particular, the inclusion of a modified version of the "absolute priority rule" has created challenges for the Singapore creditors' scheme of arrangement,[243] and could be difficult to operate in practice in the context of a creditors' scheme of arrangement that does not typically involve a holistic restructuring of all economic interests in the company (so as to achieve a restructuring that conforms with that rule); and
- **Limiting criteria**: The Singapore cross-class cram down has an additional requirement (not contained in Chapter 11 or the UK restructuring plan) that it is to be approved by 75% by value of all creditors meant to be bound by the scheme of arrangement (ie aggregated across all classes) present and voting at the scheme meetings.[244] This requirement has the potential to significantly limit the availability of the cross-class cram down in practice, but it is unclear whether there is any principled basis for such a restriction.

Likewise, we consider that Chapter 11 of the US Bankruptcy Code to be too dissimilar to creditors' schemes of arrangement for the cross-class cram down available in respect of a United States plan of reorganisation to be a helpful model to base an Australian cross-class cram down for creditors' schemes of arrangement on.

We do note one point of caution. The UK cross-class cram down regime is still relatively new, and its usage and impact is still being developed and explored. It is possible that issues will arise in its operation as this process continues (see discussion at section 5.4(h) above). That being said, any such issues would also need to be resolved in the UK market, and given the sophistication of the restructuring market and English judges it seems to us that Australia would be better placed to adopt this model and benefit from any such experiences and adjustments that may be needed along the way, rather than seeking to create a bespoke system for Australia.

7.8 Who benefits from a cross-class cram down?

In the course of our discussions with stakeholders and TMA members one comment that was made was that in practice the parties who tend to benefit from cross-class cram downs, and who tend to take the equity in restructured companies, are usually

242 In addition, in our experience, Singapore courts tend to issue less written decisions than those in Australia or the UK in respect of creditors' schemes of arrangement, which also results in less accessible jurisprudence to draw upon.

243 The absolute priority rule is reflected in *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(4).

244 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 70(3)(b).

sophisticated distress, credit or private equity funds. These funds are often managed and comprised of investors that are offshore. This raises the question as to whether a cross-class cram down is largely for the benefit of sophisticated foreign investors rather than Australian companies, banks or investors.

As discussed at section 4.6 above, it is the case that secondary debt investors have become an important group in large restructurings in Australia, and have tended to be the parties most willing to pursue restructurings resulting in a debt for equity swap (and therefore the funds owning the majority or all of the company).

However, the role of such funds needs to be appreciated more holistically in terms of what they bring to the Australian restructuring market. Funds and other secondary investors are willing to buy into a distressed company's debt, invest further capital and support a restructure that will ultimately result in the turnaround of the company and preserve more value. These restructurings also tend to result in no losses or disruption to trade creditors and employees. Par lenders and banks may be less willing or able to invest the time and further funding to support a restructuring and turnaround for a range of reasons, including: regulatory capital constraints, a focus on loss mitigation (rather than investment "upside") or institutional processes and norms.

The secondary market therefore allows banks to "sell out" of a distressed situation at a market price (typically reflecting a current distressed sale value), and for funds to buy in and capitalise on the increased value generated by the restructuring and taking a longer term position as the company carries out a turnaround. In theory this generates benefits for both parties — banks get a quicker, easier exit and do not have to bear the risk of the success of the restructuring or the costs of holding equity. Funds get the opportunity for an equity style investment uplift. Directors, management, employees and trade counterparties and stakeholders receive the benefit of a restructured company with a stronger balance sheet and typically do not have to take any losses on the transaction.

The ability to carry out debt for equity swaps, and efficiently cram down out of the money junior creditors and shareholders facilitates this dynamic, and ultimately allows distressed funds to pay more to primary lenders to acquire their debt, as there will be less uncertainty on implementation of the restructuring or "value leakage" to "out of the money" stakeholders to obtain consents. The TMA is of the view that the availability of an efficient, predictable and fair cross-class cram down mechanic therefore, will create broader benefits for lenders, the credit market and the wider economy.

8 Other creditors' scheme of arrangement reforms

8.1 Overview

We consider that there are a number of further reforms in respect of creditors' schemes of arrangement that would significantly improve their operation. We set out those reforms in this section, and the reasons why the TMA is of the view they should be made.

(a) Recommended further reforms

In summary, these recommended further reforms are:

- **Practice statement (section 8.2)**: a practice statement should be adopted in Australia similar to that used in respect of UK schemes of arrangement and restructuring plans. Such a practice statement would mandate best practice requirements in respect of class composition and jurisdictional issues at the first court hearing, and require that creditors are appropriately notified in advance of the first court hearing so they can meaningfully participate in that hearing.
- **Streamline ASIC review process (section 8.3)**: reduce the period for ASIC review of scheme documents. This is not required in other jurisdictions, and comes at a real cost to companies and their creditors.
- **Extend scheme jurisdiction to foreign companies (section 8.5)**: allow foreign companies to propose creditors' schemes of arrangement where they have a "sufficient connection" to Australia. Such an approach would be in line with that in the UK and Singapore, and would allow more flexibility for companies to restructure using the Australian creditors' scheme of arrangement process where this was appropriate and beneficial.
- **Public disclosure of scheme explanatory statements (section 8.6)**: require all scheme explanatory statements to be lodged with ASIC. Scheme explanatory statements are not confidential, but currently there is variance in approach to whether they are publicly disclosed. Given the materiality of the information (and the scheme) to other creditors and members of the company, such disclosure is appropriate.
- **Voting thresholds (section 8.7)**: the headcount test should be abolished in respect of creditors' schemes of arrangement. It no longer serves any useful purpose in respect of creditors' schemes of arrangement, especially in light of the other creditor protections inherent in the scheme process. The headcount test does, however, create significant uncertainty due to the potential for vote splitting to influence the outcome. We consider that the 75% value threshold should remain as is.
- **Pre-packaged schemes (section 8.8)**: a regime should be introduced to allow a more streamlined scheme process where the votes to pass the scheme have already have been "locked-up" at the outset of the process. In such cases the formal meeting of creditors and related convening hearing are redundant. Provided there are suitable safeguards, we consider allowing schemes to proceed with a single court hearing in such instances would promote efficiency and reduce cost.
- **Additional class powers (section 8.9)**: grant the court the power to make binding determinations as to class composition at the first court hearing and the

discretion to approve a scheme even if the classes have been wrongly constituted.

(b) Rescue or "DIP" financing

We also discuss the merits of the introduction of a rescue or DIP financing regime at section 8.4.

We do not think that the introduction of such a regime would meaningfully assist companies undertaking restructuring to access interim financing for the reasons we discuss in that section.

In any event, in the case of large companies at least (that are likely to undertake creditors' schemes of arrangement), the commercial incentives already inherent in the restructuring process in most cases work reasonably well to ensure that viable companies are funded through to completion of their restructurings.

8.2 Introduction of a Practice Statement

(a) The explanatory statement

Under section 412 of the Corporations Act, a company proposing a creditors' scheme of arrangement must provide creditors with an explanatory statement containing *inter alia*:

- an explanation of the effect of the compromise or arrangement; and
- information material to the making of a decision by a creditor as to whether or not to agree to the compromise or arrangement.

At the first court hearing, the court must satisfy itself that, if the scheme were approved by creditors and unopposed at the final court hearing, the court would be likely to approve it.[245] As part of considering this question, the court will want to satisfy itself that the explanatory statement will provide proper disclosure to its addressees.[246] See section 4.2 for a more detailed discussion on the scheme process.

It is usually the case in Australia that, apart from the members of the ad hoc group of creditors who have been negotiating the terms of the creditors' scheme of arrangement, the first time that other scheme creditors get to see the details of the scheme of arrangement (and the ancillary arrangements) is when they receive the explanatory statement. This means that there is often only a limited window (commencing only *after* the first court hearing) for those other creditors to raise any concerns or objections.

The consequence of this is that such concerns or objections often have to be raised at the final court hearing. And, if the Court ultimately agrees with their concerns or objections and declines to approve the scheme of arrangement, considerable cost and expense will have been wasted.

As a policy matter, it is clearly preferable for any difficult issues to be ventilated at the first court hearing (or with the scheme company before the first court hearing).

(b) The English scheme Practice Statement and Practice Statement Letter

In the UK, scheme creditors who are not part of the ad hoc group of creditors that has negotiated the terms of a scheme of arrangement, receive more information at an earlier stage than they would under an Australian scheme of arrangement.

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245 *FT Eastment & Sons Pty Ltd v Metal Roof Decking Supplies Pty Ltd* (1977) 3 ACLR 69, 72.

246 *Re Orion Telecommunications Limited* [2007] FCA 1389, [5].

Such creditors will receive a detailed letter from the scheme company reasonably ahead of the first court hearing (as discussed below, generally 14–21 days before the first court hearing). There is no equivalent requirement in Australia.

This letter is required by a practice statement issued by the Chancellor of the High Court of England and Wales titled "Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)" (the **Practice Statement**).[247] The Practice Statement explains the procedures that are expected to be followed with respect to the Court and disclosure procedures in connection with a scheme of arrangement. Such a letter is referred to as a **Practice Statement Letter**.

The Practice Statement Letter is a very pragmatic and sensible solution to difficult information asymmetry issues in creditors' schemes (that is, between the members of the ad hoc group of scheme creditors and the other scheme creditors). We think there would be considerable merit in adopting a similar regime in Australia.

(c) History and purpose of the Practice Statement

The history and purpose of the Practice Statement and the Practice Statement Letter was summarised by Snowden J in *Re ColourOz Investment 2 LLC*:[248]

> The origins of the provisions in the former Practice Statement and the New Practice Statement for a company to give notice of the convening hearing to scheme creditors lie in the decision of the Court of Appeal in *Hawk Insurance* [2001] 2 BCLC 480 ("Hawk"). The Practice Statement marked a change in the practice under which the company was solely responsible for the formulation of the classes and took the risk that it would be found to have got the classes wrong only at the sanction hearing. By that time it would be too late and any error in the formulation of the classes would mean that the court had no jurisdiction to sanction the scheme. The Practice Statement was thus designed both to require the company to address class issues with the court, and to encourage any creditors who wished to do so to challenge the company's formulation of the classes at the convening hearing.
>
> Whilst the court would always have to address a class question even if raised at sanction (because it goes to jurisdiction), the implicit warning now repeated in paragraph 10 of the New Practice Statement is that unless a good reason can be shown, such a late submission is unlikely to be well received and might, in an extreme case, justify disallowing an opposing creditor's costs, or even making an adverse costs award. But the *quid pro quo* is that proper notice should be given to creditors so that they have an effective opportunity to consider the matter, take advice and if so advised, appear at the convening hearing at which the constitution of the classes is determined.
>
> It has become a feature of Part 26 creditor schemes in recent years that "ad hoc groups" of creditors negotiate with a company over a significant period and reach an agreement in principle for a restructuring long before any proposal is put to creditors more generally. In this way, such ad hoc groups of creditors have significant influence over the shape that a restructuring takes, become intimately familiar with its terms, and may (subject to signing confidentiality agreements) have access to unpublished financial information concerning the company. The ad hoc group then sign a lock-up agreement with the company, agreeing to support the restructuring plan, and the company publishes the commercial terms of the proposal and advertises the level of support for it. The company then invites other creditors also to lock-up in return for a "consent" fee which acts as an incentive for other creditors to commit to the proposal at an early stage. In this way, it is increasingly the case that by the time the formal scheme process is launched and the court becomes involved, the commercial deal has been done, and achieving the statutory majorities at the scheme meetings is assured provided the court agrees with the classes proposed by the company.
>
> In these circumstances, the requirement to give adequate notice to creditors of the convening hearing has in practice nothing to do with giving notice to the creditors who

247 This replaced the (then) existing *Practice Statement (Companies: Schemes of Arrangement)* [2002] 1 WLR 1345.

248 [2020] EWHC 1864 (Ch).

have already been closely involved in negotiating a scheme and/or who have already locked up to support the scheme. The requirement to give notice of the convening hearing is part of the court's essential role to ensure the fairness of the process and to provide appropriate protection to the minority from the use of majority power which a scheme of arrangement necessarily involves. Rigorous compliance with procedural fairness may also be an important factor in obtaining international recognition of the scheme in other jurisdictions.[249]

(d) Classes composition requirements under the Practice Statement

The first area covered by the Practice Statement is the approach to class composition.

The Practice Statement provides that:

- it is the applicant's responsibility to determine whether one or more meetings of creditors and/or members is required. If appropriate, this is to be resolved early in the proceedings;
- it is the applicant's responsibility to draw attention to any issues which may arise as to the constitution of meetings, the court's jurisdiction to sanction, or any other matter that might lead the court to refuse to sanction the scheme of arrangement; and
- if a creditor or member wishes to raise issues going to matters of class composition, this must be done at the convening hearing, unless there are good reasons for raising these issues at the later sanctioning hearing.[250]

(e) Notification of creditor requirements under the Practice Statement

The Practice Statement also covers both how creditors are to be notified regarding a scheme, and what information they must be given, in greater detail than is currently contained in section 411 of the Corporations Act. The Practice Statement provides that:[251]

- The applicant should take all steps reasonably open to it to notify any person affected by the scheme of arrangement of the following matters:
  - that the scheme is being promoted;
  - the purpose which the scheme is designed to achieve and its effect;
  - the meetings of creditors and/or members which the applicant considers will be required and their composition;
  - the other matters that are to be addressed at the convening hearing;
  - the date and place fixed for the convening hearing;
  - that such persons are entitled to attend the convening and sanction hearings; and
  - how such persons may make further enquiries about the scheme.
- It is the responsibility of the applicant to ensure that notification is given to interested parties in a concise form and is communicated to all persons affected by the scheme in the manner which is most appropriate to the circumstances of the case.

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249 [2020] EWHC 1864 (Ch), [43]–[46].

250 *Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)* [2020] 1 WLR 4493 [2], [6], [10].

251 *Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)* [2020] 1 WLR 4493 [7], [8], [13].

- Save for circumstances where there are good reasons for not doing so, notification must be given to interested parties in sufficient time to enable them to consider what is proposed, to take appropriate advice and, if so advised, to attend the convening hearing. What is adequate notice will depend on all the circumstances.[252]

The Practice Statement does not mandate a specific period of time by which the Practice Statement Letter must be sent to creditors, it merely notes the need for creditors to receive it in "sufficient time" ahead of the first court hearing.

The question of what constitutes "adequate notice" has been considered in a number of cases (with the general custom being 14–21 days' notice, although in some cases a shorter period will be acceptable and in other cases a longer period may be appropriate).

As noted by Zacaroli J in *Re ED&F Man Treasury Plc* [2020] EWHC 2290 (Ch) at [9]:

> There is no hard and fast rule as to the appropriate notice period, but in reaching a view in a particular case, the following factors are relevant: the urgency of the case as a result of the financial condition of the Company, not as a result of the delay in the Company getting to this point; the extent to which there has been prior engagement with creditors; the likely degree of sophistication of the creditors; and the complexity of the scheme and of the issues raised for consideration at the convening hearing.

(f) Requirement in the Practice Statement to raise issues with the Court at the first court hearing

The effect of the Practice Statement is not just to force scheme companies to raise key issues with the court at the first court hearing.

The Practice Statement also places an onus on scheme creditors to raise any concerns or objections with the court at the first court hearing.

The court expects creditors to make their submissions in relation to any matters of concern at the first court hearing (rather than the final court hearing).[253]

As explained by Zacaroli J in *Re Gategroup Guarantee Ltd*:[254]

> By paragraph 10 of the Practice Statement, the court may reconsider any of the issues referred to in paragraph 6 at the hearing of the application to sanction the scheme. The court will in practice, however, require good reason to be shown before it does so […].[255]

As a policy matter, it is clearly preferable for the court to deal with any concerns or objection, as best as possible, at the first court hearing.

(g) Difficulties with current Australian practice at and ahead of the first court hearing

By way of contrast, in Australia, there have been a number of instances where scheme creditors, with only limited information about the nature and structure of the creditors' scheme that affects their rights, have flagged objections with the court at the first court hearing but have noted (and the court has accepted) that they were not in a position to fairly ventilate their concerns due to the fact that they only had access to limited information ahead of the first court hearing.[256]

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252 *Practice Statement (Companies: Schemes of Arrangement under Part 26 and Part 26A of the Companies Act 2006)* [2020] 1 WLR 4493, [8].

253 *Re Smile Telecoms Holdings Ltd* [2021] EWHC 395 (Ch), [20].

254 [2021] EWHC 304 (Ch).

255 [2021] EWHC 304 (Ch), [40].

256 See, for example, *Re Centro Properties Limited* [2011] NSWSC 1171, [62]–[66].

There is a judicial desire in Australia and the UK to deal with key issues at the first court hearing (rather than have those matters dealt with at the final court hearing).[257]

The deficiencies in the current Australian regime were highlighted in recent commentary as follows:

> Unfortunately, there is no equivalent to the Practice Statement in Australia, and therefore there is some variance in the level of disclosure to creditors ahead of the convening hearing. There has also been a recent trend towards last minute changes to the scheme terms. In the case of Tiger, changes were made to the scheme booklet up to 24 hours before the convening application. It also appears that IFC needed to seek a court order to obtain the material that Tiger intended to rely upon in support of its application at the convening hearing (and then only obtained this material three days before the hearing).[258]

The Australian Courts — like the English Courts before the commencement of the Practice Statement[259] — have criticised the current system in Australia where key issues (such as class or disclosure issues) are often left to be adjudicated by the court at the final court hearing because objectors are not armed with sufficient information to be able to properly ventilate the issues at the first court hearing.[260]

Finkelstein J made the following relevant comments in *Re Opes Prime Stockbroking Limited* [2009] FCA 813 at [19]–[20] after the Practice Statement was published:

> A new practice statement was published in [2002] 1 WLR 1345. Under the new practice the applicant for a scheme meeting must draw to the attention of the court as soon as possible any issue that may arise about the constitution of the meetings or which might otherwise affect the conduct of the meetings. If appropriate, notice must be given to any person affected by the proposed scheme so they may apply to be heard at the convening application. I adopted this practice in *In the Application of United Medical Protection Limited* [2007] FCA 631.
>
> The purpose of the new practice is to avoid the waste of costs and court time which would result if it were not until the approval hearing that it was determined that classes were wrongly constituted. In England it has been said that this underlying purpose means that if other issues which go to the jurisdiction of the court to approve a scheme (as in *Re Savoy Hotel Ltd* [1981] 1 Ch 351), or issues which would lead the court unquestionably to refuse the scheme, should also be dealt with at the convening application: *Re T & N Ltd (No 3)* [2007] 1 All ER 851, 862.

As noted by the current Chief Justice of the New South Wales Supreme Court, Bathurst CJ, in Australia, the court is left to deal with class and other important issues "as best it can on the material then before it", which is less than an ideal situation for the court, scheme proponents, creditors and other relevant stakeholders (including employee and other third parties with contractual relationships with the scheme company).

(h) Introduction of a Practice Statement in Australia

TMA recommends that Australia adopt requirements similar to those set out in the Practice Statement by:

- legislating for an equivalent Australian Practice Statement in the Corporations Act (to be provided for in regulations); and

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257 See, for example, *Re United Medical Protection Ltd* [2007] FCA 631, [9]. *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241, [18]–[22] (Chadwick LJ); *Re T&N Limited* [2006] EWHC 1147 (Ch), [18]–[19]. See also *Re Noble Group Limited* [2018] EWHC 2911 (Ch), [60]–[76].

258 Paul Apáthy and Angus Dick, 'Australian Restructuring: Legislation, Transactions and Cases' in GRR Insight, *Asia-Pacific Restructuring Review 2021* (Law Business Research, 2020) 14.

259 See, for example, *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241, [18]–[22] (Chadwick LJ).

260 See, for example, *Re United Medical Protection Ltd* [2007] FCA 631 at [8]–[9].

- setting out the Practice Statement itself in the *Corporations Regulations 2001* (Cth) (the **Corporation Regulations**), so that the statement could more easily be amended as circumstances and practices change.

We recommend this legislative approach as a court-sponsored practice statement is unlikely to work in Australia for a number of reasons, including the fact that, unlike in the UK where there is a single court with jurisdiction over all schemes of arrangement, in Australia the Federal Court as well as each of the State Supreme Courts have jurisdiction in respect of schemes of arrangement.

Introduction of a Practice Statement regime would ensure that creditors are provided with the necessary information to ensure that at all key stages of the scheme process, they are able to consider how their rights and interests may be impacted and how best they can be protected. Importantly, it would put creditors in the position where they are armed with sufficient information to be able to raise any concerns with a scheme of arrangement at the first court hearing (rather than having to wait until the final court hearing).

This would address the complaints and issues identified with current Australian scheme practice (as discussed in section 8.2(g) above), and would generally bring Australian in line with best international practice. It will also ensure better procedural fairness (especially given scheme applications are essentially *ex parte* proceedings), and reduce the risk of "ambushes" at the first court hearing.

This would also have the added advantage of giving more certainty to the scheme process for scheme proponents. Rather than having the threat of a challenge at the final court hearing hanging over them like the Sword of Damocles, scheme companies would be able to embark on a scheme process knowing that all material issues have been ventilated at the first court hearing.

8.3 Streamlining the ASIC review process

(a) The ASIC review requirement

Section 411(2) of the Corporations Act provides that:

> The Court must not make an order pursuant to an application under subsection (1) or (1A) [i.e. convening a meeting of creditors in respect of a scheme of arrangement] unless:
>
> (a) 14 days notice of the hearing of the application, or such lesser period of notice as the Court or ASIC permits, has been given to ASIC; and
>
> (b) the Court is satisfied that ASIC has had a reasonable opportunity:
>
> (i) to examine the terms of the proposed compromise or arrangement to which the application relates and a draft explanatory statement relating to the proposed compromise or arrangement; and
>
> (ii) to make submissions to the Court in relation to the proposed compromise or arrangement and the draft explanatory statement. [261]

ASIC states in its Regulatory Guidance that it considers that the 14-day period referred to in section 411(2)(a) will generally be the minimum period ASIC requires to examine the draft scheme documents (under section 411(2)(b)), but that schemes that are novel or more complex will often require more time.[262]

During this period, ASIC will provide any comments on the draft explanatory statement to the scheme company. ASIC articulates its role in schemes as follows:

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261 *Corporations Act 2001* (Cth), s 411(2);

262 ASIC, 'RG 60 Schemes of arrangement' (Regulatory Guide No 60, September 2020) [60.33].

Our role is to assist the court by:

(a) reviewing the content of scheme documents;

(b) reviewing the nature and function of the scheme;

(c) representing the interests of investors and creditors (where in many cases we may be the only party before the court other than the applicant);

(d) helping to ensure that all matters that are relevant to the court's decision are properly brought to the court's attention before it orders meetings or before it confirms a scheme; and

(e) registering scheme documents.[263]

ASIC may also appear at a court hearing in connection with a scheme if it objects to the scheme or if it is of the opinion that there are issues that ought to be drawn to the court's attention. ASIC may appear as *amicus curiae* (that is, as helper or adviser to the court) or under section 1330(1) of the Corporations Act.

In the context of a distressed company, this 14-day period obviously comes at a real cost to the scheme company (and its outstanding creditors) where every day may count. So it is important to ask whether this 14 day period is necessary and value adding in the context of a creditors' scheme of arrangement.

(b) The Practice Statement Letter will assist ASIC

In our view the introduction of the Practice Statement, and Practice Statement Review Letter could be used to make ASIC's review process more efficient.

Assuming the Practice Statement is introduced in Australia, we think that scheme proponents should be required to send the Practice Statement Letter to ASIC at the same time as it is sent to creditors. This should result in ASIC having additional time to consider a scheme of arrangement ahead of the first court hearing and to assess whether it is appropriate for it to allocate its scarce resources to scrutinising a particular scheme of arrangement (particularly if, as is usually the case, the scheme creditors comprise entirely of highly sophisticated and well-resourced financial institutions, credit funds, private equity houses and the like).

The Practice Statement Letter will help ASIC get on top of the issues far more quickly than they may otherwise be able to do so by simply wading through (what are usually) very lengthy, complex and dense explanatory statements. By way of example, the disclosure documentation relating to Boart Longyear Ltd's latest scheme of arrangement proposals stretched to 1,313 pages.[264]

The Practice Statement Letter, in contrast, is required to be short and to clearly identify the key issues that need to be drawn to the Court's or creditors' attention in advance of the first court hearing. In our view, this will make ASIC's review more efficient and will assist ASIC to focus on the most important issues.

(c) Shortening the ASIC review period to 7 days

Given that the introduction of the Practice Statement Letter regime will ensure that ASIC will generally receive relevant information about a creditors' scheme earlier than it currently does, and will provide notice as to many of the key issues, the TMA recommends that the time ASIC should be given to review a draft explanatory statement be reduced from the current 14 days to 7 days (see section 411(2)(a) of the Corporations

263 ASIC, 'RG 60 Schemes of arrangement' (Regulatory Guide No 60, September 2020) [60.4].

264 See Boart Longyear Ltd, 'Boart Longyear recapitalisation & redomiciliation – update' (ASX Announcement, 29 July 2021).

Act). There is no need for such a long period, particularly if the financial position of the scheme company is precarious.

This 7 day period would align with the time that ASIC is given to review a prospectus (see section 727(3) of the Corporations Act) and the period that the ASX has to review an explanatory statement under which an approval is sought from security holders (including debt holders) under the ASX Listing Rules.[265] If the above Practice Statement approach is taken, the TMA does not consider that ASIC needs to be given longer to review a draft explanatory statement, noting that:

- the ASIC review process is unique to Australia (for example, the Financial Conduct Authority does not review explanatory statements in the UK ahead of the first court hearing in a UK scheme of arrangement); and
- as mentioned above, in most cases, the creditors that will be the subject of a creditors' scheme of arrangement will be highly sophisticated players in the debt restructuring markets who do not need ASIC's protection; and
- the 14-day review period is not cost free.

8.4 Rescue or DIP financing regime

(a) Introduction of rescue financing for Australian creditors' schemes of arrangement

The Consultation Paper asks stakeholders whether the introduction of a rescue (or debtor-in-possession) finance regime should be considered in the context of Australian creditors' schemes of arrangement.

We assume what is envisaged in this regard is something like the rescue financing regime recently introduced in Singapore as part of the broader creditors' schemes of arrangement reforms in that jurisdiction (and as discussed further at section 5.3(d) above).

The TMA considers the availability of financing to distressed companies to be an important factor in successful restructuring and turnaround.

However, we do not consider that a rescue financing regime of the sort enacted in Singapore or contained in section 364 of the US Bankruptcy Code is likely to be a useful addition to the Australian creditors' scheme of arrangement framework.

Furthermore, interim financing needs will frequently arise long before the company is proposing a creditors' scheme of arrangement, and therefore it makes little sense to tie a rescue financing regime to this final stage in the restructuring process.

In practice, existing financiers are usually willing to advance interim funding to viable companies (at least those of a size and scale that are likely to be undertaking creditors' schemes of arrangement) where this is needed to achieve a restructuring (and provided the financiers have not lost confidence in management or the business).

Where this is not the case, a US-style rescue financing regime is unlikely to assist in practice for the reasons discussed below.

That being said, we do consider this an issue that should be continued to be considered by the Government given the importance of interim finance to successful restructuring. However, as with the introduction of a debtor-in-possession moratorium, the complexities in this area mean that this is something that the TMA feels is better left for a more holistic

[265] See Boart Longyear Ltd, 'Boart Longyear recapitalisation & redomiciliation – update' (ASX Announcement, 29 July 2021).

review, as opposed to being "tacked on" to a reform of creditors' schemes of arrangements.

(b) Interim financing in Australian "out-of-court" restructurings

In a distressed situation, interim or rescue financing is frequently needed in order to ensure that the company has sufficient funding to keep trading for the period required to develop, negotiate and implement a restructuring between the company and its financiers, a process which can frequently take 6 months or longer.

Given the distressed state of the company during this period, and the uncertainty as to whether a restructuring will be achieved (or the terms thereof) it is almost invariably the case that any such interim financing will only be advanced by a financier if they rank ahead of other creditors in an insolvency.[266]

The key question is whether and how such priority can be bestowed on a financier willing to provide such financing. In an "out-of-court" restructuring, the company is not subject to any formal insolvency regime, and therefore (generally – see further comments at section 8.4(f) below) is not restricted in its ability to borrow funds or grant security, except to the extent it is subject to contractual restrictions on its ability to do so (in its existing financing arrangements) and has already granted security over its assets. In most cases a company undergoing restructuring will have already granted "all-asset" security to its senior financiers, and there will be covenants in the financing documents restricting further debt incurrence without their consent (although sometimes subject to "baskets" permitting certain types and amounts of debt incurrence).

As a matter of practice, therefore, most interim financing is provided by some or all of the existing financiers. The existing financiers are, in theory at least, incentivised to advance such financing if it will allow a restructuring that will result in a better recovery on their existing debt. It also avoids the potentially difficult intercreditor negotiations that would be required to bring in a third party financier whose incentives may not be aligned with the existing financiers. If the existing financiers do not wish to advance the further funding required to promote a restructuring, they will frequently be willing to trade their debt to a secondary investor who will. Whilst the system is far from perfect, in the current market in practice we have not observed companies having significant difficulty accessing interim funding where it is needed to keep trading through to a restructuring.

(c) DIP financing under Chapter 11[267]

Whilst the Chapter 11 debtor-in-possession financing regime has frequently been suggested as an important reform to allow companies better access to interim funding, we are not convinced that such a regime is likely to make a significant difference to the existing dynamics outlined above.

Section 364 of the US Bankruptcy Code provides for the Bankruptcy Court to make orders bestowing a series of priority rankings on financing advanced to a company in Chapter 11. However, where a company has already granted security over all of its assets to existing financiers, the only ranking that will ensure priority over the existing debt is if the court grants the highest priority, allowing the company to grant a "priming lien" that ranks ahead of all existing security. Given the extraordinary nature of this remedy, and the emphasis placed on respecting property rights granted to holders of

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266 This approach is reflected in the "Eighth Principle" of INSOL International's influential *Statement of Principles for a Global Approach to Multi-Creditor Workouts II* (Report, April 2017), which states: "If additional funding is provided during the Standstill Period or under any rescue or restructuring proposals, the repay of such additional funding should, so far as practicable, be accorded priority status as compared to other indebtedness or claims of relevant creditors."

267 The summary in this section has been adapted from the discussion of the United States and Singapore rescue financing regimes contained in Paul Apathy, *Post-petition financing in the United States and Singapore* (INSOL Short Paper, 28 February 2019).

security, such an order may only be made where there is "adequate protection" of the interests of the existing secured creditor (and where the debtor company is otherwise unable to obtain such credit).[268]

The concept of adequate protection is defined to encompass:[269]

- one or more cash payments to the existing secured party, to the extent the new security results in a decrease in the value of the existing secured party's interest in the secured property;
- granting the existing secured party an additional or replacement security to the extent the new security results in a decrease in the value of the existing secured party's interest in the secured property; or
- granting such other relief as will result in the realisation by the existing secured party of the 'indubitable equivalent'[270] of its interest in the secured property.

In practice one of the most common ways that debtors seek to satisfy the adequate protection requirement in the United States is to demonstrate there is a sufficient "equity cushion" in the collateral.[271] An existing secured party is considered to have an equity cushion if the value of its secured collateral exceeds the amounts of its debt (plus any debt with priority over its debt).[272] The courts will also look at whether collateral is depreciating in value and at what rate, when determining if the equity cushion is sufficient.[273]

Another relatively common method is for the debtor to make a series of cash payments to the existing secured party. Single cash payments are not normally used, because if the debtor had free cash equal to the new financing such financing would not be required.[274]

In any application for an order to prime existing security, there will be significant emphasis on the value of the collateral secured by the existing security. The US Bankruptcy Code does not provide any guidance as to how the value of the secured property should be ascertained. As a result, United States bankruptcy courts have taken a range of approaches, including going concern, liquidation and fair market values.[275]

Despite the attention given to the ability to prime existing secured creditors, there have been relatively few reported cases in the United States under section 364(d). It is far more common for a Chapter 11 debtor to use the threat of priming to persuade pre-petition lenders to extend post-petition credit than for a debtor to actually seek an order to

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268 *Bankruptcy Code 1978*, 11 USC § 364(d) (2021).

269 *Bankruptcy Code 1978*, 11 USC § 361 (2021).

270 The term 'indubitable equivalent' is not defined in the US *Bankruptcy Code*.

271 Daniel V Goodsell, 'Extending Post-petition Credit to Reorganizing Debtors: Understanding the Tricks and Traps of Bankruptcy Code Section 364' (1990) 1 *Utah Law Review* 93, 106.

272 Paul M Baisier and David G Epstein 'Postpetition Lending Under Section 364: Current Issues – Incentives to Lenders to Provide Financing to Borrowers Who Are the Subject of Bankruptcy Cases' (1994) 41 *Federal Bar News & Journal* 190, 191. See for example: *Re Snowshoe Co* 789 F.2d 1085, 1088 (Hall J) (4th Cir, 1986); *Re Dunes Casino Hotel* 69 BR 784 (Bankr. D NJ, 1986).

273 *Re Dunes Casino Hotel* 69 BR 784, 794–5 (Gambardella J) (Bankr. D NJ, 1986).

274 Jane Lee Vris and Richard London, *An Introduction to DIP Financing* (Research Discussion Paper, Vinson & Elkins LLP, 2007) 10–14 <https://www.velaw.com/uploadedFiles/VEsite/Resources/Wallanderv5PLIBankrBasicsFinancingOutline2007.pdf> visited 27 February 2019>.

275 Jane Lee Vris and Richard London, *An Introduction to DIP Financing* (Research Discussion Paper, Vinson & Elkins LLP, 2007) 12–13 <https://www.velaw.com/uploadedFiles/VEsite/Resources/Wallanderv5PLIBankrBasicsFinancingOutline2007.pdf> visited 27 February 2019>.

grant a new post-petition lender a priming lien.[276] This is because it can be extremely difficult to prove there is adequate protection (and the debtor has the burden of proof in this regard)[277] unless the pre-existing secured creditor is significantly over-secured, and a priming application will typically be fiercely contested, expensive and time consuming.[278] It is relatively rare for a court to approve priming liens over the objection of a pre-petition lender.[279]

As noted by Marcia Goldstein and Sara Coelho:

> Entitlement to adequate protection before liens securing new money may 'prime' or be pari passu with liens of existing lenders makes it difficult, if not impossible, to find a 'new money' lender for a debtor that has pledged all or nearly all of its assets. It therefore provides pre-petition secured lenders holding all-assets security with tremendous leverage. As a result, these lenders are often the only source of funding for the business in Chapter 11.[280]

As a result, the usual practice in the United States, despite the existence of the DIP financing regime, is for existing pre-petition lenders to provide any required DIP financing on a consensual basis. In other words, in much the same way as happens in practice in Australia.

(d) Rescue financing in Singapore

The TMA notes that the Singapore rescue financing provisions (discussed at section 5.3(d)) above, are closely modelled on the section 364 of the US Bankruptcy Code. Given the resemblance, the Singapore provisions give rise to similar issues in practice to those that arise under section 364.[281]

Despite the initial enthusiasm regarding the introduction of rescue financing in Singapore, to our knowledge there have been no financings that have primed existing secured creditors. The relatively small number of rescue financings to date appear to have mainly granted an unsecured preferential priority upon liquidation, or (in at least one cases involved granting security over unsecured assets).

We understand that there has also been resistance in Singapore by local banks to the concept of rescue financing being advanced to companies without the consent of existing lenders which has also limited the uptake of these provisions.

(e) Timing issues

In addition to the mechanical issues noted above, it is important to bear in mind how "out-of-court" restructurings work in practice. As we discuss at section 4.5 above, most of the time of the restructuring process is spent long before the formal creditors' scheme of arrangement process starts. The formal implementation process under a creditors' scheme of arrangement is the (relatively) short period that comes at the end of the process.

Accordingly, to the extent that a company requires interim rescue financing, it is likely to need it prior to the proposal of the scheme of arrangement. Furthermore, by that stage of

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276 Paul M Baisier and David G Epstein 'Postpetition Lending Under Section 364: Current Issues – Incentives to Lenders to Provide Financing to Borrowers Who Are the Subject of Bankruptcy Cases' (1994) 41 *Federal Bar News & Journal* 190, 106–7.

277 *Bankruptcy Code 1978*,11 USC § 364(d)(2) (2021).

278 Richard M Kohn, Alan P Solow and Douglas P Taber, 'Pure Debtor-In-Possession Financing' (1995) *Secured Lender* 6, 14.

279 Michael L Bernstein and George W Kuney, *Bankruptcy in Practice* (American Bankruptcy Institute, 5th Edition, 2015) 262.

280 Marcia L Goldstein and Sara Coelho, 'The United States of America' in Gregor Baer and Karen O'Flynn (eds) *Financing Company Group Restructurings* (Oxford University Press, 2015) [25.30].

281 Paul Apathy, *Post-petition financing in the United States and Singapore* (INSOL Short Paper, 28 February 2019).

the process, the "implementation phase", the restructuring is more or less assured and there will be a majority group of supporting financiers. In such circumstances financing should be significantly easier to obtain. The greater challenge is during the preceding "negotiation" period. For much for the same reasons as discussed in respect of the moratorium (at section 6.11), it therefore doesn't make much sense to tie any rescue financing regime to the creditors' scheme of arrangement process.

(f) Priority rescue financing should be explored as part of broader reforms

Notwithstanding the issues outlined above, the TMA does consider that the issue of priority rescue financing is worthy of further Government review, as part of a more holistic review of Australian restructuring and insolvency law.

Despite the comments above regarding the commercial incentives in larger distress situations for existing lenders to advance credit, we expect there are likely some cases where this does not occur. It would be helpful for some data to be collected in this regard to understand whether this is a significant issue in practice, and if so in which areas and what is causing the difficulties. We note that when the UK explored the introduction of a priority rescue funding regime, the large majority of respondents opposed such measures, and many noted that "the market already functioned well in offering rescue finance to viable businesses".[282]

There are also a number of issues that can arise to complicate the advance of interim financing even where there is some willingness by existing lenders to do so. These issues can include:

- restrictions under existing financing documents preventing lenders from providing new funding. Such restrictions may arise because of:
  - restrictions on the amount of priority debt or new money that can rank ahead of junior or other existing creditors; or
  - restrictions on the ability for debt to rank ahead of senior creditors without the consent of some or all of the senior lenders (or limited "baskets" for such priority funding);
- existing "par lenders" are often less willing to advance more than the bare minimum in interim financing to distressed borrowers (as opposed to distressed investors who are typically more willing to do so where it makes commercial sense) — therefore availability and extent of funding may depend upon whether the situation is attractive to secondary investors (and whether existing lenders are willing to divest their position); and
- in larger syndicates it may be difficult to reach consensus on the advance of funding, and the terms of the documentation may vary as to whether inserting such funding on a priority basis can be done with the consent of majority lenders or requires the consent of all lenders.

An example of these sorts of issues, and how they were overcome is the recent UK (first) creditors' scheme of arrangement in respect of Swissport Fuelling Ltd. In that case an initial scheme of arrangement was used to bind the senior creditors to consent to permitting the advance of interim financing on a super senior basis. Miles J explained the rationale and scheme as follows:

> The Group is now facing a severe liquidity crisis, with its available cash resources expected to drop to a critical level by the final week of July 2020. To address this liquidity crunch the Group wishes to be able to borrower up to Euro 380 million of new money under a new loan facility ("the New Money Facility"). This will provide the Group with the liquidity it needs to carry on business for the next six to nine months. During that period

[282] Department for Business, Energy & Industrial Strategy, I*nsolvency and Corporate Governance: Government response* (Response, 26 August 2018) [5.186]. See discussion at section 5.4(i) above.

> the Group also intends to seek to implement a broader restructuring of its financial liabilities, with a view to carrying on operating as a going concern over the longer term.
>
> The Group's existing financial liabilities arise under a number of different debt instruments and creditor facilities. These include a Credit agreement dated 14 august 2009 by which the Group has borrowed something over Euro 1 billion under three different facilities. There is also an Intercreditor Agreement of the same date, which governs the ranking of liabilities under the Credit Agreement and certain other liabilities of the Group.
>
> The scheme creditors are the lenders under the Credit agreement. Any New Money Facility is bound to have to be given a ranking ahead of the existing senior liabilities of the Group. Any lenders of new money would require that super senior ranking. To enable this to happen, the consent of the lenders under the Credit Agreement and the Intercreditor Agreement is required, and the principal purpose of the proposed scheme is to effect that consent.[283]

The scheme was successful and allowed the super senior funding to be advanced ahead of the existing secured lenders (and a second scheme was ultimately undertaken at a later date to deleverage the group once the restructuring was agreed).

Clearly such a solution will not be practical in all circumstances where there are difficulties agreeing interim priority financing, and accordingly we consider this issue should be considered further by the Government as part of broader reforms.

8.5 Extension of scheme jurisdiction to foreign companies with sufficient connection to Australia

(a) Australian schemes can only be used in respect of Part 5.1 bodies

Under existing law, the Corporations Act only allows for a "Part 5.1 body" to be the subject of an Australian creditors' scheme.

A Part 5.1 body is defined as:

- a company that is incorporated in Australia; or
- a foreign company or an Australian body which is registered under Part 5B.2 of the Corporations Act.

Whilst it is theoretically possible to register a foreign company under Part 5B.2 of the Corporations Act that can be a slow and cumbersome process which carries with it some not insignificant ongoing compliance burdens.[284]

In practice therefore, Australian schemes of arrangement tend to be limited to Australian incorporated companies.

(b) Difficulties of restructuring cross border groups

This can lead to difficulties and inefficiencies in seeking to implement a beneficial restructure of an Australian (or partially Australian) corporate group. By way of example:

- a large Australian corporate group will often have foreign subsidiaries which cannot currently be the subject of an Australian creditors' scheme; and
- irrespective of whether a foreign company is part of a large Australian corporate group, a foreign body corporate may have entered into a financing agreement which is governed by an Australian law.

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283 *Re Swissport Fuelling Ltd* [2020] EWHC 1499 (Ch), [3]–[5].

284 See, for example, the process and compliance requirements in the *Corporations Act 2001* (Cth) ss 601CE, 601CK.

This issue arose in the creditors' scheme of arrangement in *Re Tiger Resources Ltd*[285] which involved a debt-for-equity swap. In that case, the borrower (**SEK**) was a subsidiary of Tiger Resources Ltd (an Australian company listed on the ASX). SEK (a foreign companies) as the main operating entity within the Tiger Group and was the principal debtor in the Tiger Group. It was said that, if the proposed creditors' scheme was not implemented, Tiger Resources and its subsidiaries, including SEK, would become insolvent. SEK had no direct connection to the Australian jurisdiction and therefore could not be the scheme company (despite it being the logical entity to be the scheme company).

So as to enliven the operation of the Australian scheme of arrangement regime, as an elaborate part of the restructuring, the scheme provided that Tiger Resources would assume a portion of SEK's secured debt and the assumed debt would then be the subject of a debt-for-equity swap. One of the senior lenders challenged the scheme of arrangement, alleging that it was not a "compromise or arrangement" within the meaning of the Australian creditors' scheme of arrangement provisions, as the scheme provided for the assumption of the very debt that was needed to have jurisdiction — a "bootstraps" type approach. Notwithstanding these conceptual difficulties the Court ultimately approved the scheme of arrangement.

However, the case illustrates the difficulties caused by the limited Australian scheme jurisdiction. Furthermore, it is not clear that the elaborate solution to engineer jurisdiction used in the *Tiger* case will be available in future cases.

(c) "Good forum shopping"

There are also other scenarios where it may be appropriate or beneficial to deal with a foreign company under or in connection with an Australian creditors' scheme of arrangement.

Using local scheme of arrangement processes in respect of foreign companies is common practice in other jurisdictions such as the UK and Singapore. These jurisdictions actively market their schemes of arrangement processes to foreign companies with the aim of attracting cross-border restructurings to be carried out in those jurisdictions (this is seen as high value professional services work, and essentially a "product" that can be marketed to companies operating in jurisdictions with less attractive restructuring regimes or less reliable judicial systems).

The ability to carry out restructurings under UK or Singapore schemes can be attractive to both foreign debtor companies and their financial creditors, seeking to restructure in an efficient and predictable manner — something the courts have labelled "good forum shopping".[286]

In *Re Codere Finance (UK) Limited* [2015] EWHC 3778 (Ch) at [17]–[19], the Court said:

> Aside, however, from that fact, the authorities show that over recent years the English courts have become comfortable with exercising the scheme jurisdiction in relation to companies which have not had longstanding connections with this jurisdiction. Mr. Allison has reviewed the authorities in detail in his skeleton argument, referring me, for example, to cases dealing with companies which have shifted their centres of main interest; a relatively recent authority in which there was a change of governing law; and, by way of perhaps particular analogy to the present case, a line of authorities including the decision of Mr. Justice Norris this year in *Re A I Scheme Ltd*. reported at the convening stage at [2015] EWHC 1233 (Ch) and, at the sanction stage, at [2015] EWHC 2038 (Ch). In that case, a company had voluntarily assumed liabilities with a view to the

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285 [2019] FCA 2186.

286 As to the distinction between "good forum shopping" and "bad forum shopping": see Chief Justice Sundaresh Menon, 'The Future of Cross-Border Insolvency: Some Thoughts on a Framework Fit for a Flattening World' (Speech, 18th Annual Conference of the International Insolvency Institute, 25 September 2018). See also Riz Mokal, 'Shopping and scheming and the rule in Gibbs' [2017] (March) *South Square Digest* 58.

scheme jurisdiction being exercised. Mr. Justice Norris did not consider that that fact prevented the English court from sanctioning the proposed scheme.

In a sense, of course, what was done in the *A I Scheme* case, and what is sought to be achieved in the present case, is forum shopping. Debtors are seeking to give the English court jurisdiction so that they can take advantage of the scheme jurisdiction available here and which is not widely available, if available at all, elsewhere. Plainly forum shopping can be undesirable. That can potentially be so, for example, where a debtor seeks to move his COMI with a view to taking advantage of a more favourable bankruptcy regime and so escaping his debts. In cases such as the present, however, what is being attempted is to achieve a position where resort can be had to the law of a particular jurisdiction, not in order to evade debts but rather with a view to achieving the best possible outcome for creditors. If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping.

In the particular circumstances of this case, I cannot see that the fact that the company has been acquired only recently, and with a view to invoking the scheme jurisdiction, should cause me, in the exercise of my discretion, to decline to sanction the scheme. For reasons I have already touched on, the scheme appears to be very much in the interests of the group's creditors. I bear in mind in that context the fact that it was devised following close consultation with creditors; the overwhelming level of support that it has enjoyed from creditors; the fact that no creditor has opposed the scheme; the lack of alternatives available to the group in other jurisdictions; and the fact that, on the evidence, my declining to sanction the scheme could cause the group and its creditors a loss of value of around €600 million, by any standards a large sum.

Australia is much less of a cross-border financing hub than either London or Singapore, and therefore it can be expected that the opportunities for Australia to attract this sort of work would be less common. However, Australia does have a well-regarded restructuring and insolvency regime, experienced practitioners and an excellent judiciary.

It is, therefore, at least possible that Australia could be seen as an attractive jurisdiction to carry out some cross-border restructurings in the broader region. The TMA thinks this is worth exploring.

(d) UK scheme jurisdictional requirements

By way of contrast to the position in Australia, a company can only enter into a scheme of arrangement under Part 26 of the UK Companies Act if it is a company liable to be wound up under the UK Insolvency Act.

An unregistered company may be wound up under the UK Insolvency Act under section 221. An unregistered company includes "any association and any company, with the exception of a company registered under the UK Companies Act in any part of the United Kingdom".

Accordingly, foreign companies are within the ambit of Part 26 of the UK Companies Act meaning that the English courts have a potentially "exorbitant jurisdiction" in the case of English schemes of arrangement involving foreign companies.[287]

The English courts have articulated three "conditions" that go to the discretion of the court as to whether to exercise its jurisdiction in respect of a scheme of arrangement involving a foreign company, being

- there must be a sufficient connection with England and Wales;
- there must be a reasonable possibility, if a winding-up order is made, of benefit to those applying for the winding-up order; and

[287] *Re Far East Capital Ltd* [2017] EWHC 2878 (Ch), [31].

- one or more persons interested in the distribution of assets of the company must be persons over whom the court can exercise a jurisdiction.[288]

In *Re Drax Holdings Ltd*[289], Collins J explained that, as these three conditions were originally formulated in a winding up context, the second and third conditions may not be relevant in the case of a particular scheme of arrangement involving a foreign company. However, his Lordship further stated that the first condition "would plainly be relevant in any event".[290] His Lordship later said:

> The court should not, and will not, exercise its jurisdiction unless a sufficient connection with England is shown.[291]

Accordingly, it is now well accepted that a court will not exercise its jurisdiction in respect of a foreign company unless there is a "sufficient connection" with England.

The English courts will not approve a scheme in respect of a foreign company where to do so would not be likely to serve any real purpose. Accordingly, an English court will only approve such a scheme of arrangement if:

- there is a sufficient connection with the English jurisdiction; and
- it is likely that the scheme will achieve its purpose — the court will want to know that it is not acting in vain.[292]

The English courts have confirmed that the "sufficient connection" requirement will be satisfied if (among other things):

- the scheme company is incorporated in England and Wales (even if the scheme company has only recently been incorporated);
- the relevant agreement between the creditors and the scheme company is governed by English law (even if the governing law has been changed to English law for the specific purpose of the scheme);
- if the scheme company's centre of main interest (**COMI**) is England and Wales (even if it has been moved to England for the specific purposes of the scheme) this is likely to be relevant to satisfying the "sufficient connection" requirement. That said, it is not essential that the scheme company has its COMI or an establishment or any assets in England (indeed, it is not essential that the scheme company has any physical presence or connection with England); or
- the scheme company has assets in England.

(e) Singapore scheme jurisdictional requirements

In Singapore, a similar test exists for which companies can be the subject of a scheme of arrangement: a company must be capable of being wound up under the IRDA.[293] However unlike the UK, the question of a "substantial connection" goes to whether a

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288 *Re Drax Holdings Ltd* [2004] 1 All ER 903, 908 [22], 909 [26].

289 [2004] 1 All ER 903.

290 [2004] 1 All ER 903, 909 [25].

291 [2004] 1 All ER 903, 909–10 [29].

In *Re Far East Capital Ltd* [2017] EWHC 2878 (Ch), Snowden J explained (at [31]) that the need for there to be a "sufficient connection" with England is "rooted in a concern that the English court should not exercise what other jurisdictions might regard as an exorbitant jurisdiction over foreign companies".

292 See, for example, *Re Van Gansewinkel Groep BV* [2015] EWHC 2151 (Ch), [71].

293 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) ss 63(3); 246(3).

company is eligible to be wound up, and therefore establishes the jurisdiction of the Court.[294]

In determining whether such a connection exists, the Singapore courts will consider whether:

- Singapore is the COMI of the company;
- the company is carrying on business in Singapore or has a place of business in Singapore;
- the company is a foreign company that is registered under Division 2 of Part XI of the *Companies Act* (Singapore, cap 50, 2006 rev ed);
- the company has substantial assets in Singapore;
- the company has chosen Singapore governing law for a loan or other transaction; and / or
- the company has submitted to Singapore's jurisdiction for the resolution of a dispute relating to a loan or other transaction.[295]

The list of factors that may be considered in determining whether a substantial connection exists under section 246(3) of IRDA is not exhaustive. In *Re PT MNC Investama TBK* [2020] SGHC 149, the first case where a foreign company applied to take advantage of the moratorium under section 64 of IRDA, an Indonesian investment company was able to satisfy the substantial connection test on the basis that its securities were listed on the Singapore Stock Exchange — despite none of the six criteria listed above being satisfied.[296]

While the IRDA confers upon the Singapore High Court a broad discretion as to whether a company has sufficient connection to Singapore, the test does not account for the intention of the parties to the company's debt documents. A sufficient connection to Singapore may exist notwithstanding an agreement between the company and its creditors that a loan be governed by the laws of a foreign jurisdiction.

(f) Foreign recognition of scheme

It should be noted that even if a UK or Singapore court considers it has jurisdiction to sanction a scheme in respect of a foreign company, this does not mean that the scheme will be regarded as legally valid in the company's home jurisdictions (or in the jurisdiction governing its finance contracts or liabilities).

This will be a question of whether the laws of that other jurisdiction "recognise" the scheme as valid. This will depend on the "conflict of laws" or "private international law" rules applying in that other jurisdiction. In a number of jurisdictions such recognition may be sought under the version of the UNCITRAL Model Law enacted in that country, although it will depend how that law has been enacted and construed in that country.[297] There may also be other avenues of recognition.

(g) Australian recommendations

In the TMA's view, Part 5.1 of the Corporations Act should be amended to provide Australian courts with jurisdiction to approve a scheme of arrangement in respect of:

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294 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) ss 63(3); 246(3); *Re PT MNC Investama TBK* [2020] SGHC 149, [9]–[11].

295 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore) s 246(3).

296 *Re PT MNC Investama TBK* [2020] SGHC 149, [9]–[11].

297 Recognition of Australian creditors' schemes of arrangement has been sought (and obtained) in the United States, pursuant to Chapter 15 of the US Bankruptcy Code on a number of occasions. Chapter 15 is the legislation reflecting the UNCITRAL Model Law in the United States.

- a Part 5.1 body (as is currently the case); or
- a foreign company (even if not registered under Division 2 of Part 5B.2) that has a "sufficient connection" to Australia.

This would essentially be adopting the approach to scheme jurisdiction reflected in English case law.

The question of whether there is a "sufficient connection" would ultimately be a matter for the discretion of the Court taking into account all the facts and circumstances.

However, the TMA also recommends that the Corporations Regulations provide a non-exhaustive list of factors that the court can take into account in determining whether there is a "sufficient connection" to Australia, such as to warrant the court assuming jurisdiction. Those factors should include where:

- the scheme company is incorporated in Australia or is a foreign company registered under the Corporations Act (that is, it is a "Part 5.1 body");
- the scheme company has an Australian COMI;
- the scheme company has an Australian bank account (with funds in it) or other assets in Australia;
- the debt obligations owed to the scheme creditors by the scheme company are governed by an Australian law; and / or
- the scheme creditors have submitted to the jurisdiction of Australian courts for dispute resolution purposes.

The utilisation of a "sufficient connection" test would enable the Australian courts to draw on the principles coming out of the extensive UK case law where this issue has been considered.

8.6 Public disclosure of explanatory statements

(a) No existing requirement to publicly disclose creditors' schemes of arrangement

Presently, in relation to creditors' schemes of arrangement, there is no requirement that the explanatory statements that are required to be prepared (and sent to the relevant class or classes of creditors) be publicly disclosed.

This may be contrasted with the position for members' schemes of arrangement where explanatory statements are required to be lodged with ASIC for registration so that they are publicly available.[298]

In the TMA's view, this inconsistency should be remedied and explanatory statements in respect of creditors' schemes of arrangement should be lodged with ASIC and made publicly available.

(b) Third parties are affected by creditors' schemes of arrangements

Often, the creditors affected by a creditors' scheme of arrangement are not limited to the class (or classes) of creditors that are party to the scheme. Subject to certain limits (such as the choice not being arbitrary), a company is generally free to select which creditors it wishes to include within a scheme of arrangement.[299]

So, for example, it is very rarely the case that trade creditors will be party to a creditors' scheme of arrangement. There is therefore often a significant group of creditors which,

[298] *Corporations Act 2001* (Cth), s 412(6).

[299] See, for example, *Re MAB Leasing Ltd* [2021] EWHC 152 (Ch), [8].

whilst being affected by the scheme of arrangement, have no opportunity to review the explanatory statement.

Furthermore, the courts have confirmed that they are entitled to take account of the objections of third parties whose rights and interests are affected by a creditors' scheme of arrangement.[300]

If a third party's rights or interests are to be affected by a scheme of arrangement, it is appropriate that those third parties have access to the explanatory statement so that they can assess whether it is appropriate to object to a creditors' scheme of arrangement or bring matters to the court's attention.

(c) Inconsistencies with other disclosure regimes

If a scheme company is listed on the ASX, the explanatory statement must be filed with the ASX and made publicly available, so all creditors (including those who are not party to the scheme) are informed of the impact of the scheme on their rights and interests.[301] It is anomalous that if the scheme company is unlisted the explanatory statement will not be made publicly available and creditors who are not party to the scheme of arrangement will not able to establish the impact of the scheme on their rights and interests.

Additionally, the Corporations Act requires companies that are undertake various corporate actions to lodge the relevant explanatory statements with ASIC. Those corporate actions include buy backs[302], capital reductions[303] and financial assistance.[304] A creditors' scheme of arrangement is likely to have a far more significant impact on the rights or interests of creditors than any of those corporate actions. In such circumstances, it is difficult to rationalise the argument for requiring explanatory statements for less significant corporate actions to be publicly available but not requiring explanatory statements for creditors' schemes (that is, a much more significant corporate action) to be publicly available.

(d) The original justification no longer exists

The original justification for the difference in registration requirements between members' schemes and creditors' schemes was that it was thought that "time may be more critical" in a creditors' scheme.[305] This justification is no longer valid today given that it was articulated a number of years *before* ASIC was given a 14-day statutory period[306] to review draft explanatory statements before the first court hearing and given that the act of registration is now a purely mechanical one by ASIC which can be undertaken relatively quickly following the first court hearing.

(e) No bar to disclosure

Additionally, explanatory statements are not themselves confidential documents nor is the creditors' scheme of arrangement a confidential process. To the contrary, it is noted:

- there is nothing in the Corporations Act that prevents scheme creditors from freely sharing an explanatory statement with a third party;

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300 See, for example, *Re Wiggins Island Coal Export Terminal Pty Ltd* [2018] NSWSC 1434, [14]; *Re Swissport Fuelling Ltd* [2020] EWHC 3413 (Ch), [35].

301 See, for example, Boart Longyear Ltd, 'Explanatory Statement' (9 July 2021).

302 *Corporations Act 2001* (Cth) ss 257C(3), 257D(3) 257E.

303 *Corporations Act 2001* (Cth) s 256C(5).

304 *Corporations Act 2001* (Cth) s 260B(5).

305 See Explanatory Memorandum, Companies Bill 1981 (Cth), 350 [778].

306 ASIC (and its predecessors) only acquired its 14-day statutory period to review draft explanatory statements ahead of the first court hearing for the first time on 31 March 1986.

- copies of explanatory statements often circulate amongst sophisticated investors in the market — there should be equal access to explanatory statements to all (particularly to those (often) less sophisticated parties to whom or to which the explanatory statement is still highly relevant, such as trade creditors and other third parties having dealings with a scheme company);
- the two court hearings in a scheme of arrangement — where the terms of a scheme of arrangement are discussed — are open to the public; and
- the orders that a court makes in connection with a creditors' schemes must be lodged with ASIC (and are therefore publicly available).[307]

This makes it all the more anomalous that the Corporations Act does not make explanatory statements themselves publicly available so that *all* third parties (including creditors, shareholders, employees and other third parties) can assess the impact of a scheme of arrangement on their rights and interests and, if considered appropriate, raise their concerns with the scheme company, ASIC or the court.

In the unlikely event that an explanatory statement does need to contain confidential information, this can easily be dealt with by scheme proponents seeking an order from the court to protect that confidentiality.[308]

By way of comparison, in a Chapter 11 process under the US Bankruptcy Code it is generally the case that all documents will be publicly available.

(f) Public interest

We also think there is a significant public interest justification for disclosure of the relevant documents and orders relating to a creditors' scheme of arrangement.

A creditors' scheme of arrangement is a formal statutory process in respect of an incorporated entity. Where a company is utilising the court process and undertaking a public process which affects its affairs, and adjusts the rights and obligations of third parties in respect of that company, we think it is appropriate that this is disclosed in a manner similar to other corporate activity and in accordance with the principle of open justice.

The legitimate public interest, and the importance of open justice, in regard to creditors' schemes of arrangement was expressly recognised by Snowden J in *Re Port Finance Investment Limited* [2021] EWHC 454 (Ch), a case where Reorg (a restructuring industry subscription service) sought access to some of the evidence underlying the scheme court applications:

> Performing the "fact-specific balancing exercise" referred to by Lady Hale in Dring, I consider, first, that the primary purpose of the open justice principle, namely to allow public scrutiny of the decisions of the judges and therefore to enhance confidence that judges are making their decisions properly, is especially important in scheme cases. Such cases do not merely involve a determination or declaration of rights, but involve a compulsory alteration of the rights of non-assenting creditors against their will or without their consent. That is pre-eminently a process that should be open to close scrutiny.
>
> In this regard I do not place any weight upon the argument made by the Scheme Company that Reorg is a subscription service provided to a limited number of organisations. It is inherent in the concept of open justice that public scrutiny should be capable of being conducted by persons other than the parties directly affected by the decision in question. Given the highly technical and specialist nature of schemes, it is inevitable that such scrutiny of decisions in scheme cases will be more effectively conducted by specialists and professionals in the restructuring industry rather than by the man in the street.

307 See, for example, *Federal Court (Corporations) Rules 2000* (Cth), rr 3.3, 3.5.

308 See, for example, *Re Smile Telecoms Holdings Ltd* [2021] EWHC 395 (Ch), [49]–[51].

In that respect, Reorg's subscriber base of over 20,000 is not insignificant in number, it must include a high proportion of the specialist advisers in the restructuring industry, and Reorg's commentary is likely to be picked up by other interested media organisations. Further, and in any event, if Scheme Creditors do seek advice about the Scheme, it is quite possible that they will do so from someone with access to the Reorg service.

Moreover, in the case of an international scheme such as the present, the parties affected are not confined to the UK, and so when one speaks of facilitating public scrutiny and enhancing public confidence in judicial decision-making, it is not simply the public in the UK that needs to be considered. Rather, in order to ensure recognition abroad, it is essential to ensure that there is confidence internationally that the English court is conducting a rigorous, fair and transparent restructuring process. Making the process fully accessible to media organisations with an international reach such as Reorg can perform an important role in that regard.

I also reject the argument by the Scheme Company that it is relevant that Reorg charges a subscription fee and is seeking to enhance the commercial value of its service by using the information in the witness statements. Very few media organisations operate on a not-for-profit basis: most seek to make a profit and charge in some way for their services, whether that be the price for a newspaper or periodic journal, or a subscription payment for a television channel or online service.

Such organisations doubtless hope that the information that they obtain and their analysis of it will enhance the value of their publications or programming, thereby justifying their charges and increasing their subscriber base and profitability. But I do not see why any of that should lead to a conclusion that such organisations are not performing a legitimate journalistic function, or that they cannot serve the principles of open justice. There is also no suggestion in Dring of the restricted approach for which the Scheme Company contends.

Lady Hale's explanation of the second purpose of the open justice principle – making the case comprehensible and allowing the public to understand why the judge reached his decision - is also entirely applicable in the instant case.

The documentation for a modern scheme case can be extensive. The evidence often runs to many hundreds, if not thousands of pages. In the instant case, the bundle for the convening hearing ran to just short of 2,000 pages. To make such evidence digestible, counsel usually (and helpfully) provide detailed written arguments summarising the case and the judge has the opportunity to pre-read. The result is that oral hearings can be conducted very efficiently by way of an abbreviated dialogue between the court and counsel, and the contents of the witness statements will not be read out in open court. The inevitable consequence, however, is that even where (as was the case at the convening hearing) a copy of the skeleton argument is made available to persons attending the hearing, it can be impossible for an observer to discover the detail of the evidence or argument. That can certainly be the case where (as occurred in the debate over the Success Fee) the court asks questions which go beyond the information provided in the skeleton argument, and supplemental evidence is filed.

I give some weight to the fact that, as the Scheme Company submits, the witness statements contain little (if any) detail about the structure of the Success Fee that was not captured in the convening judgment. But although the structure of the proposal may have been captured in the judgment, there is additional evidence in the witness statements as to the genesis, terms and rationale of entering into such an arrangement from the Group's point of view that I did not think it essential to replicate in the convening judgment. In that respect, as Lady Hale pointed out in paragraph [44] of Dring, one object of the open justice exercise is to enable the observer to relate what the judge has done or decided to the full range of the material which was before him. The observer should be able to assess the approach taken by the judge for itself. In the instant case, it is, of course, possible that with its background knowledge of the restructuring industry, Reorg may be able to pick up nuances in the evidence that did not occur to me.[309]

In our view the comments of Snowden J set out above have even more force in respect of the scheme explanatory statements, given these documents set out the key terms of

309 *Re Port Finance Investment Limited* [2021] EWHC 454 (Ch), [13]–[21].

the scheme, the reasons the scheme is required, and the anticipated effect of the scheme on the company and other parties.

Incorporation and limited liability is a significant privilege, but the trade-off is that there is public disclosure as to the company's financial position and legal status. Accordingly, we consider that it is good corporate practice, consistent with broader corporations law policy and in the interests of general market and commercial transparency that the explanatory statement (and any related orders) be made publicly available at ASIC.

We also consider that such disclosure will allow better study and understanding of the operation of creditors' schemes of arrangement in Australia, which will allow better and more informed discussion in respect of any future law reform in this space.

(g) TMA's recommendation

The TMA therefore submits that the gap in disclosure requirements between members' schemes of arrangement and creditors' schemes of arrangement be closed, and a requirement be introduced that creditors' scheme of arrangement explanatory statements be lodged with ASIC and made publicly available.

For similar reasons, any order made pursuant to section 411(16) of the Corporations Act should also be required to be lodged with ASIC. This would be consistent with the various rules requiring lodgement of orders in respect of the first court hearing and the final court hearing of the scheme.[310]

8.7 Voting thresholds — removal of headcount test and the retention of 75% by value voting threshold

(a) The head count test — background

Under section 411(4)(a)(i) of the Corporations Act, a creditors' scheme of arrangement is only binding upon a class of creditors if, in addition to requiring a 75% vote by value, the scheme is agreed to by a majority in number of the creditors included in that class of creditors, present and voting, either in person or by proxy. This is known as the "headcount test" or the "numerosity test".

Introduced (well over 100 years ago) to (presumably) protect small creditors, the headcount test in practice allows creditors with comparatively little economic exposure to have a disproportionate influence on the outcome of a compromise or agreement under a creditors' scheme.

(b) CAMAC's recommendations

CAMAC, which was only specifically considering members' schemes, invited submissions on a range of issues in relation to voting at scheme meetings, including whether the headcount test should be retained, modified, dispensed with or replaced.[311] CAMAC ultimately recommended that the headcount test be abolished, stating:

> The Committee recommends the removal of the headcount test for the approval of schemes. While the test might be seen as adding to the protection of small shareholders (for whom some implications of a scheme may differ from those for larger shareholders), it has the potential to result in the blocking of a scheme even where the holders of the overwhelming number of shares in the company have voted in favour. Also, the

310 See *Federal Court (Corporations) Rules 2000* (Cth), rule 3.5; *Supreme Court (Corporations) Rules 1999* (NSW), rule 3.5; *Supreme Court (Corporations) Rules 2013* (Vic), rule 3.5; *Supreme Court (Corporations) (WA) Rules 2004* (WA), rule 3.5; *Corporations Rules*, Part 6.3, rule 3.5 (these Rules are Schedule 6 to the *Court Procedure Rules 2006* (ACT)); *Corporations Law Rules 2000* (NT), rule 3.5; *Supreme Court (Corporations) Rules 2008* (Tas), rule 4; *Rules for proceedings under Corporations Act or ASIC Act*, Part 3, rule 3.5 (these Rules are Schedule 1A to the *Uniform Civil Procedure Rules 1999* (Qld)) and *Corporations Rules 2003* (SA), rule 3.5.

311 Corporations and Markets Advisory Committee, *Members' schemes of arrangement* (Discussion Paper, June 2008) 51–63 [4.1]–[4.3].

headcount test does not accommodate the situation where there are multiple beneficial owners behind a single legal owner of shares.

The Committee considers that decisions on fundamental corporate matters should ultimately be determined by the shares voted, rather than the number of shareholders. This is already the case with other changes to a company that may fundamentally affect shareholders. These include changes to a company's constitution and other important matters that call for approval by special resolution. The approval requirement for a special resolution, 75% of shares voted, is the same as the threshold test for schemes.

Small shareholders have other protections, such as the duties of directors to act in the interests of shareholders generally in proposing the scheme, the requirement for shareholders to vote in separate classes where their interests differ, the requirement for an expert's opinion, the role of ASIC in reviewing the terms of a scheme and the discretion of the court in approving a scheme. It is also open to minority shareholders to approach ASIC or the court if they are concerned that their interests are being unduly prejudiced.

The Committee recognises that removal of the headcount test could be seen as making schemes more attractive than bids in some circumstances. However, as discussed in Chapter 3, there is a range of factors to take into account in determining whether to proceed by way of a bid or a scheme. Also, as indicated above, the Committee considers that the 75% voted shares test is in line with the voting threshold for other important corporate decisions and is appropriate for schemes.

The Committee is not persuaded of a need to change the voted shares test if the headcount test is abolished. There was no strong call for change by respondents. The current approval threshold (75% of shares) is in line with that for other significant changes to the company, such as amendments to the constitution and other matters that call for a special resolution. Dissenting shareholders have the opportunity to express their views at the shareholder meeting and to raise their concerns at the second court hearing. Also, as pointed out in submissions, a minority of hostile shareholders may have the voting power in some circumstances to defeat a scheme proposal. A requirement for a higher approval threshold, say 90% by value of shares voted, would constitute a significant impediment to the implementation of schemes, for no good purpose.[312]

Although CAMAC was only considering members' schemes, its conclusions are also directly relevant to creditors' schemes as well. In a very real sense, small minority shareholders are in a similar position to small creditors.

(c) Discretion to dispense with the headcount test — the approach on members' schemes of arrangement

Parliament introduced a discretion in the context of members' schemes to dispense with the head count test to address circumstances where the outcome of the head count vote was manipulated through share splitting.[313] As this practice can just as easily be deployed in a creditors' scheme through debt splitting, there is no reason not to extend this court discretion to creditors' schemes as well.[314]

It is often the case that there are only a relatively small number of creditors within a class, so the potential for debt splitting to derail and defeat — or otherwise greenmail — an otherwise meritorious creditors scheme is real (and can be very difficult to prove). It is not in the public interests that creditors' schemes can be defeated by such nefarious tactics.

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312 Corporations and Markets Advisory Committee, *Members' schemes of arrangement* (Discussion Paper, June 2008) 92–4 [5.4.2]–[5.4.4].

313 Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007 (Cth), 57 [4.179]–[4.181].

314 See *SK Engineering & Construction Co Ltd v Conchubar Aromatics Ltd* [2017] SGCA 51, for an example of debt splitting occurring in a creditors' scheme, in the context of seeking to have the scheme passed (rather than to block the scheme).

Debt splitting can occur right up until the time of the creditor vote. Accordingly, a scheme company could get very close to the end of a lengthy creditors' scheme process which will rescue it from the alternative of insolvency and which is overwhelming supported by its creditors (by value) but yet find its creditors' scheme is defeated on the headcount test — thus resulting in a significant waste of time and cost, not to the potentially catastrophic impact of the company collapsing if the restructuring fails.

(d) Approach to voting under a DOCA

We note that there is still a headcount test that applies to voting in an administration, including in connection with approving a DOCA.[315] However, the TMA considers there are important protections and safeguards that apply to creditors' schemes of arrangement that do not apply to DOCAs. These differences justify a difference in approach between the two processes. The differences include that in a creditors' scheme of arrangement there is:

- court supervision and oversight of the entire creditors' scheme process;
- the class voting regime, where creditors with different rights vote in separate classes (thus, for example, unlike a DOCA, secured financiers cannot vote in the same class as trade creditors or employees — under a DOCA all creditors vote in the same class);[316]
- the power of the court to discount or disregard votes of particular creditors on the grounds of extraneous commercial interests;[317] and
- the court's broad fairness discretion which it must exercise in deciding whether to approve a creditors' scheme that has achieved the statutory majorities.[318] The court is not bound by the majority vote at the scheme meeting and will take into account the legitimate objections of any scheme creditor or other third party.[319]

Furthermore, where creditors vote on a DOCA proposal, if the proposal receives approval on the majority by value test but is defeated on the majority by number test, it is open to the administrator to exercise its right to lodge a casting vote in favour of the DOCA. The court has no similar discretion in connection with a creditors' scheme.

(e) Economic rationale

There is no economic justification for the retention of the headcount test — it was removed from the takeover regime in Chapter 6 of the Corporations Act on 13 March 2000 with the commencement of the *Corporate Law Economic Reform Program Act 1999* (Cth). It makes no sense for a creditor with just $1 of debt to have the same voting power as a creditor with $100 million of debt. Corporate debts can today be freely bought and

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315 The approval threshold for a DOCA includes a requirement that it be agreed to by a majority of the creditors voting (either in person, by attorney or by proxy), both in number and by value: see *Corporations Act 2001* (Cth) s 1364(2)(f); *Insolvency Practice Rules (Corporations) 2016* (Cth) ss 75-115(1)–(2).

316 The classic articulation of the class test is contained in *Sovereign Life Assurance Company v Dodd* [1892] 2 QB 573, 583. The class voting regime is explained in detail in T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks* (University of Sydney Press, 3rd ed, 2013) 287–302 [6.2].

317 See, for example, *Re Chevron (Sydney) Ltd* [1963] VR 249, 255; *Re Jax Marine Pty Ltd* [1967] 1 NSWR 145, 148. The ability of the Court to discount or disregard votes is explained in detail in T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks* (University of Sydney Press, 3rd ed, 2013) 302–10 [6.3].

318 The classic articulation of the Court's fairness discretion is contained in *Re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213, 247. The Court's fairness discretion is explained in detail in T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks* (University of Sydney Press, 3rd ed, 2013) 148–58 [4.4].

319 See, for example, *Re Centro Properties Ltd* [2011] NSWSC 1465.

sold in the secondary debt markets — small parcels of debt can just as easily be acquired as large parcels.

(f) UK reforms to the headcount test

An important distinction between Part 26A restructuring plans introduced under the CIGA and the existing scheme of arrangement regime under Part 26 of the UK Companies Act is that for a restructuring plan to bind a class of creditors or members, the relevant threshold for approval is 75% in value of creditors in each class who vote.[320] Unlike Part 26 schemes of arrangement, there is no requirement in respect of Part 26A restructuring plans that a majority in number vote in favour of the proposal.

The removal of a headcount test under restructuring plans is a major advantage for companies seeking to implement a restructure despite a lack of cooperation from hold-out creditors. In the 2016 Review, the UK Government initially proposed to retain the same headcount and value thresholds which apply to schemes of arrangement.[321] However, following public consultation, the UK Government modified the proposal to require 75% by value and 50% of the independent creditors,[322] before this too was abandoned for the lone 75% by value requirement that now appears in the UK Companies Act.[323]

(g) TMA's recommended reforms to the headcount test

The TMA considers that the headcount test should be removed, or alternatively qualified, in respect of Australian creditors' schemes of arrangement.

Specifically, the TMA makes the following recommendations:

- **Recommended proposal: Abolition of the head count test**: Consistent with the recommendation of CAMAC (discussed above), the head count test should be abolished. It is inappropriate that creditors with a small economic exposure — possibly acquired for the sole purpose of frustrating a creditors' scheme — should be able to veto a creditors' scheme which is supported by creditors holding the overwhelming majority by value of the debt. Consistent with the points mentioned by CAMAC, there are plenty of other protections for small creditors under a creditors' scheme of arrangement (including the fact that the court is not bound by the majority vote and must separately consider the fairness of a scheme as part of its broad supervisory jurisdiction over a scheme of arrangement).
- **Alternative proposal: Court to have the discretion to dispense with the head count test:** section 411(4)(a)(ii)(A) of the Corporations Act gives the court the discretion to dispense with the head count test in the case of members' schemes of arrangement only.[324] An alternative (albeit less optimal) reform proposal to the abolition of the head count test in creditors' schemes (as recommended above), is for this discretion to be extended to creditors' schemes of arrangement. We think it would be appropriate to extend the same approach to creditors' schemes of arrangement because issues such as debt splitting (that is, the breaking up of a holding of debt into multiple separate small parcels) to manipulate the results of the head count test are equally repugnant

320 *Companies Act 2006* (UK) s 901F(1).

321 The Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform* (Consultation, 25 May 2016) [9.19]–[9.20].

322 Department for Business, Energy & Industrial Strategy, *Insolvency and Corporate Governance: Government response* (Response, 26 August 2018) [5.114].

323 Robert Dicker QC and Adam Al-Attar, 'Cross-Class Cram Downs Under Part 26A Companies Act 2006, Corporate Insolvency and Governance Act 2020, Schedule 9' [2020] *South Square Digest* 34.

324 This change was introduced into the law in 2007 by the Corporations Amendment (Insolvency) Bill 2007 (Cth).

from a policy perspective in the context of creditors' schemes of arrangement.[325]

(h) Retention of the 75% by value voting threshold

In relation to whether there is a need to reduce the 75% by value test, we note that in all of the Australian creditors' schemes of arrangement that have been proposed since the GFC, to the TMA's collective knowledge, none of them failed to be implemented due to failing to pass the 75% by value test.[326] Accordingly, we see no evidence that the 75% by value test is too high and a cause for creditors' scheme to fail and we recommend that the 75% by value test be retained.

In addition, we note that creditors' schemes of arrangement in all other major common law jurisdictions (including the UK — the leading scheme of arrangement jurisdiction in the world) require a vote to be passed by creditors holding at least 75% of the value of debt. The TMA does not think it is necessary or appropriate to reduce (or increase) this threshold — such a reduction (or increase) would result in Australian creditors' schemes being out of line with all other common law jurisdictions.

We recommend that the Treasury retain the 75% by value test. We view the 75% voting threshold as an important protection for creditors. Based on the evidence of recent creditors' schemes, we do not see the high threshold as an obstacle to implementing creditors' scheme.

8.8 Pre-packaged creditors' schemes of arrangement

(a) Pre-packaged creditors' schemes of arrangement

Restructuring practitioners have in the past raised the utility of the concept of "pre-packaged" creditors' schemes of arrangement as a restructuring tool for distressed companies.

A pre-packaged scheme of arrangement is intended to allow the scheme of arrangement process to run more quickly, efficiently and cheaply in circumstances (which are often the case in modern restructuring practice) where a sufficient majority of creditors to pass the scheme have already committed to support the scheme before the formal process starts.

In such situations, where the vote at the creditors' scheme meeting is a foregone conclusion, there would seem to be little utility in going through the formal steps of convening a formal meeting of creditors, or the first court hearing that is intended to make the order convening that meeting. Instead, the process could be condensed into a single court hearing where the court checks that all the requirements have been satisfied, including: jurisdiction, class composition and general fairness (and that there is indeed sufficient evidence that there is the requisite level of creditor support). Provided the court is satisfied with these matters it can approve the scheme at that hearing.

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325 Parliament's express policy objective in giving the Court the discretion to disregard the head count test in the case of shareholders' schemes of arrangement was to neutralise the effect of "share splitting" – that is, the practice of shareholders transferring small parcels of shares to a large number of other persons with the intention of increasing the number of votes that they may cast for the purposes of the head count test: see, for example, Explanatory Memorandum, Corporations Amendment (Insolvency) Bill 2007 (Cth), [4.179], [4.181].

326 The 2016 scheme of arrangement involving Emeco Group Ltd was voted down by Black Diamond, the holder of 33% of the scheme debts (see Emeco Holdings Ltd, 'Results of creditors' scheme meeting' (ASX Announcement, 14 December 2016); Emeco Holdings Ltd, 'Explanatory Statement' (7 February 2017) 29–30 [5]). However, a few months later, the scheme of arrangement was amended and, with Black Diamond's support, was approved and implemented (see Emeco Holdings Ltd, 'Emeco receives creditors' scheme court approval' (ASX Announcement, 15 March 2017); Emeco Holdings Ltd, 'Completion of Recapitalisation and Mergers' (ASX Announcement, 31 March 2017)).

As mentioned at section 4.5 above, there is some logic to this approach in the context of modern restructuring, where sufficient creditors to pass the scheme are often "locked-up" via restructuring support agreements or similar instruments before the scheme is formally launched.

However, the lack of the formal process to consider jurisdiction, classes and the adequacy of the explanatory statement at the first court hearing puts additional emphasis on ensuring that there is appropriate disclosure to all creditors.

(b) Singapore pre-packaged schemes of arrangement

As part of Singapore's recent law reforms, it introduced pre-packaged schemes of the nature described in section 8.8(a) above.[327] Several pre-packaged schemes of arrangement have now been undertaken in Singapore,[328] and the feedback we have received from Singapore professionals on these processes to date have generally been positive (subject to the issues recently raised in *Re DSG Asia Holdings Pte Ltd*, as discussed further at section 8.8(c) below).[329]

Under section 71 of IRDA, the Singapore court may, on the application of the scheme company, make an order approving a creditors' scheme of arrangement even though no meeting of creditors (or class thereof) has been ordered or held.[330] Creditors intended to be bound by the scheme must be notified of the application, and provided with a statement that contains:[331]

- information concerning the company's property and financial prospects;
- information on how the proposed scheme will affect the rights of those creditors; and
- such other information as is necessary to enable the creditor to make an informed decision as to whether to approve the proposed scheme.

The statement must also:[332]

- explain the effect of the scheme of arrangement, and in particular state:
  - any material interests of the directors of the company; and
  - the effect that the scheme of arrangement has on those interests; and
- where the scheme of arrangement affects the rights of debenture holders, contain a similar explanation with respect to the trustees for the debenture holders.

The company must publish notices of the application in the Gazette and a daily newspaper, and send notice of the application and a copy of the application to each creditor meant to be bound by the scheme of arrangement.[333]

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327 Paul Apáthy and Emmanuel Chua, 'Singapore's new "supercharged" scheme of arrangement (2017) 18(5) *Insolvency Law Bulletin* 98, 100.

328 See Debby Lim, 'Singapore's First "Pre-Packaged" Scheme of Arrangement', *Singapore Global Restructuring Initiative* (Blog Post, 5 February 2021) <https://ccla.smu.edu.sg/sgri/blog/2021/02/06/singapores-first-pre-packaged-scheme-arrangement>.

329 *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209.

330 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore), s 71(1).

331 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore), s 71(3).

332 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore), s 71(6).

333 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore), ss 71(3)(b)–(c).

The court may not approve the scheme unless it is satisfied that, had a meeting of the (relevant) creditors been summoned, creditors comprising a majority in number, representing at least 75% of the value, of those present and voting at the meeting of each relevant class would have approved the scheme.[334] The rules do not specify what evidence would be required to demonstrate to the court that the scheme would have been approved. However, it is generally considered that scheme voting or lock-up agreements signed by the requisite majorities are an appropriate basis to draw this conclusion. We understand that signed voting forms have also been used to demonstrate the support.

To date, there has been only one published judgment from the Singapore courts on pre-packaged schemes (despite a number of such schemes being undertaken).

(c) Re DSG Asia Holdings Pte Ltd

In *Re DSG Asia Holdings Pte Ltd*, the Singapore Court dismissed an application to approve a pre-packaged scheme on the basis that the company had not fully and frankly disclosed all necessary information to creditors to enable them to make an informed decision on whether to vote for the scheme.[335]

The concern rose in respect of the assignment of some debt that was owed by the company to related entities. Prior to the scheme this debt was assigned to a third party that was described as "a potential white knight".[336] Creditors had requested disclosure of the terms and purchase price in respect of the debt trade, as they were concerned that the sale was not on an arm's length basis and was contrived to circumvent the voting requirements under the scheme of arrangement.[337] The Court considered the failure to disclose the purchase price meant that the scheme company had failed to satisfy the disclosure requirements contained in section 71(3)(a) of the IRDA in respect of pre-packaged schemes of arrangements.[338]

In the alternative, had the Court not dismissed the application on that ground, the Court also held that the scheme would have failed on the basis of the scheme classes being incorrectly constituted and therefore the scheme failing to reach the required voting threshold.[339]

The decision illustrates that the importance of full and proper disclosure where a scheme is to be undertaken on a pre-packaged basis.

(d) Benefits of pre-packaged schemes

Pre-packaged schemes help address a common criticism of creditors' schemes of arrangement; that they can be expensive and lengthy processes. They effectively allow a company to dispense with both the court hearing to convene a meeting of creditors, and the meeting itself, if it can be demonstrated that the outcome of the meeting is a forgone conclusion.[340]

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334 *Insolvency, Restructuring and Dissolution Act 2018* (Singapore), s 71(3)(d).

335 *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209, [32]–[43].

336 *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209, [10].

337 *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209, [35].

338 *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209, [41].

339 *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209, [44]–[64].

340 As to the advantages, generally, of a pre-packaged scheme: see Aurelio Gurrea-Martinez, 'The Right of Pre-Packs as a Restructuring Tool: Theory, Evidence and Policy' (Research Paper 15/2021, Singapore Management University School of Law, 2015) 9. Even in a pre-packaged scheme, the company is still required to fully and frankly disclose all information necessary to provide creditors with the information necessary to make an informed decision on whether to vote for the scheme: *Re DSG Asia Holdings Pte Ltd* [2021] SGHC 209, [32]–[43].

We also note that the Singapore pre-packaged scheme regime was the aspect of the recent Singapore law reforms that garnered the most praise in our discussions with Singapore restructuring practitioners (see section 5.3(e) above). However, as the decision in *Re DSG Asia Holdings Pte Ltd* highlights, the pre-packaged scheme process should only be used in appropriate cases where proper disclosure has been made and there is confidence in the constitution of the scheme classes.

(e) TMA's recommendation

We recommend that the Government consider whether pre-packaged schemes should be introduced in Australia. This will require further analysis, including considering how a pre-packaged scheme would interact with other reforms being considered.

8.9 Additional powers in relation to classes

Creditors must be marshalled into classes for the purposes of voting on a creditors' scheme. The time-honoured test for identifying a class for scheme of arrangement purposes is that articulated by Bowen LJ in *Sovereign Life Assurance Company v Dodd*:

> It seems plain that we must give such a meaning to the term "class" as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.[341]

The class test can be notoriously difficult to apply in practice.

The composition of classes is of fundamental importance in every scheme and a matter in respect of which particular care must be taken. This is because the failure to properly constitute a class will deprive a court of jurisdiction to approve the scheme, and will leave the court with no choice but to decline to approve the scheme, even if the scheme would still have been approved by creditors had the classes been composed correctly.

In other words, if the classes are incorrectly constituted, even if this has had no effect on the outcome of the vote, the whole scheme must fail, resulting in a considerable waste of time and expense and, worse still, possibly consigning the scheme company to the fate of insolvency. This possibility has been a matter of continuing frustration for the courts, as witnessed in the following passage:

> Under [the scheme of arrangement provisions], the court will have no jurisdiction to sanction the scheme if the classes have been incorrectly constituted. It is perhaps unfortunate that this is the case and there is much to commend an approach which enables the court to sanction a scheme in an appropriate case, where the classes have been incorrectly constituted in a way which would not have affected the outcome of the meetings.[342]

To address this issue, the Corporations Act should be amended to give the court the following powers:

- **Binding class determinations**: the Court should be given the discretion to make a binding determination on the composition of classes at the first court hearing; and
- **Curative power**: the court should be given specific discretion to approve a scheme even if the classes have been wrongly constituted.[343]

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341 *Sovereign Life Assurance Company v Dodd* [1892] 2 QB 573, 583.

342 *Re Telewest Communications plc* [2004] BCC 342, [14].

343 In December 2009, the Corporations and Markets Advisory Committee (which was considering reforms to the members' scheme of arrangement regime) concluded that, whilst it did not agree with the first of these two reform proposals, it did agree with the second of these two reform proposals: see Corporations and Markets Advisory Committee, *Members' schemes of arrangement* (Report, December 2009) 91 [5.4.1].

These are discussed in further detail below.

We consider that the court should be given the power to make a binding determination on the composition of classes or the relevance of interests at the first court hearing. This is not a power that we would expect to be engaged regularly by scheme proponents. However, in difficult or marginal cases (particularly in cases involving creditors' schemes of arrangement), rather than risking getting all the way to the end of the process only to have the court to decline to approve a scheme on class or interest grounds, the scheme proponents may consider it preferable to get a binding determination from the court to bring certainty to the process. To ensure that creditors (as the case may be) and ASIC are:

- informed of the intention to seek such a binding determination at the first court hearing; and
- given a reasonable opportunity prepare an objection to the determination and, if considered appropriate, to appear at the first court hearing to argue that objection to the Court,

the scheme proponents should be required to prepare, and make available to creditors and ASIC, a document setting out the relevant issues sufficiently in advance of the first court hearing. In this regard, the Practice Statement letter referred to in section 8.2 could fulfil that function.

Second, we consider that the court should be given specific power to approve a scheme even if the classes have been wrongly constituted or if there exist extraneous interests which may otherwise result in the overturning of the scheme vote. Although the court may already have this power in relation to class composition by virtue of section 1322 of the Corporations Act,[344] the fact that the court will lack jurisdiction to approve a scheme if the classes have been incorrectly constituted, and the fact of the often inconsistent application of section 1322 by the courts, mean that there is a legitimate basis for including a specific provision giving the court a general "curative" power in Part 5.1 of the Corporations Act.

344 For examples of where the Courts have indicated that s 1322 can be used to cure procedural irregularities in the scheme context see T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks* (University of Sydney Press, 3rd ed, 2013) 159–165 [4.5].

Schedule 1

Creditors' schemes of arrangement implemented in Australia in the post GFC period (2008 to 2021)

No.	Year[345]	Company	Amount of scheme debts	Type of scheme debts	Nature of scheme	Section 411(16) order	Decisions	% of creditors in support pursuant to an RSA or similar
1.	2009	Opes Prime Stockbroking Ltd	A$3.2 billion	All unsecured creditors	Liquidation distribution scheme	No (Company in liquidation)	**First court hearing** *Re Opes Prime Stockbroking Ltd (No 1)* [2009] FCA 813 **Final court hearing** *Re Opes Prime Stockbroking Ltd (No 2)* [2009] FCA 864	N/A
2.	2010	Lift Capital Partners Pty Ltd	A$670 million	All unsecured creditors	Liquidation distribution scheme	No (Company in liquidation)	**First court hearing** *Re Lift Partners Pty Ltd and Lift Nominees (No 1) Pty Ltd* [2009] FCA 1523 **Final court hearing** *Re Lift Capital*	N/A

345 By date of sanctioning hearing.

							Partners Pty Ltd (in liq) (No 2) [2010] FCA 84	
3.	2011	Alinta Finance Australia Pty Ltd	A$2.552 billion	Finance debt – syndicated	Deleveraging scheme (including debt for equity swap)	No (Standstill agreement)	**First court hearing** No written judgment delivered **Final court hearing** No written judgment delivered	Indication of support (non-binding) from approximately 90% by value.[346]
4.	2011	Centro Properties Ltd	A$3.2 billion	Finance debt – syndicated[347]	Deleveraging scheme (including debt for equity swap)	No (Standstill agreement)	**First court hearing** *Re Centro Properties Ltd* [2011] NSWSC 1171 **Final court hearing** *Re Centro Properties Ltd* [2011] NSWSC 1465	83% by value of the Syndicated Finance Debt.[348]
5.	2012	Nine Entertainment Group Ltd	A$3.44 billion	Finance debt – syndicated	Deleveraging scheme (including	No	**First court hearing** *Re Nine Entertainment Group*	An "expectation" of more than 75% in value and 50% by number will

346 Letter from Mallesons Stephen Jaques, 18 January 2011 'Alinta – Draft Creditors' Scheme Explanatory Statement', 3-4, item 2: 'Overview of this Explanatory Statement: Categories of Creditors'.

347 The scheme specifically excluded litigation claims. The effect of the scheme on those claims became a focus at the sanctioning hearing.

348 *Centro Implementation Agreement* in Centro Properties Group, 'Centro Group announces restructure agreement ' (Media Release, 9 August 2011) 13 <https://www.asx.com.au/asxpdf/20110809/pdf/42090trhfnxsdg.pdf>.

				Finance debt – subordinated notes	debt for equity swap)		*Ltd (No 1)* [2012] FCA 1464 **Final court hearing** *Re Nine Entertainment Group Ltd (No 2)* [2013] FCA 40	support the Scheme.[349]
6.	2013	Lehman Brothers Australia Ltd	A$470 million[350]	All unsecured creditors	Liquidation distribution scheme	No (Company in liquidation)	**First court hearing** *Re Lehman Brothers Australia Ltd* [2013] FCA 486 **Final court hearing** *Re Lehman Brothers Australia Ltd (No 2)* [2013] FCA 965	N/A
7.	2016	Atlas Iron Ltd	A$259.3 million	Finance debt – syndicated	Deleveraging scheme (including debt for equity swap)	No (Standstill agreement)	**First court hearing** *Re Atlas Iron Ltd* [2016] FCA 366 **Sanctioning hearing**	86.2% by value of debt and over 50% by number of the syndicated lenders.[351]

349 Explanatory Statement in respect of the "Nine Entertainment Group Limited", Scheme, 3.2(c) 'Support for the Scheme'.

350 This represents the quantum of class action claims which were compromised as part of the scheme, and does not include the value of other debts compromised as part of the scheme of arrangement.

351 Explanatory Statement in respect of the "Atlas Iron Limited" Scheme, 5.3 'Restructuring Support Agreement'.

							Re Atlas Iron Ltd (No 2) [2016] FCA 481	
8.	2017	Emeco Holdings Ltd	A$282 million	Finance debt – New York law governed senior notes	Deleveraging scheme (including debt for equity swap)	No (Standstill agreement)	**First court hearing** No written judgment delivered **Final court hearing** No written judgment delivered	76% in value of the Emeco Noteholders.[352]
9.	2017	Boart Longyear Ltd	A$740 million	Finance debt – New York law governed senior secured term loans and notes Finance debt – New York law governed unsecured notes	Deleveraging scheme (including debt for equity swap)	Yes (Moratorium order obtained at First court hearing)	**First court hearing** *Re Boart Longyear Ltd* [2017] NSWSC 567 **Final court hearing** *Re Boart Longyear (No 2)* [2017] NSWSC 1105	Over 75% by value of the secured debt and over 75% by value of the unsecured notes.[353]
10.	2017	Slater & Gordon Ltd	A$761.6 million	Finance debt – syndicated Unsecured claims – shareholder class actions	Deleveraging scheme (including debt for equity swap)	No (Standstill agreement)	**First court hearing** No written judgment delivered **Final court hearing**	Over 75% in value of the finance debt and over 50% in number.[354]

352 Explanatory Statement in respect of the "Atlas Iron Limited" Scheme, 6.6 'Support for the Scheme'.

353 *In the matter of Boart Longyear Limited* (2017) 121 ACSR 328, [11].

354 Slater and Gordon, 'Market Update: Shareholder Claimant Scheme Supplementary Disclosure' (ASX Announcement, 20 November 2017) 6.

							No written judgment delivered	
11.	2018	BIS Finance Pty Ltd; Artsonig Pty Ltd	A$1.2 billion	Finance debt – syndicated Finance debt – Payment in Kind (PIK) notes	Deleveraging scheme (including debt for equity swap)	No	**First court hearing** *BIS Finance Pty Ltd; Artsonig Pty Ltd* [2017] NSWSC 1713 **Final court hearing** *BIS Finance Pty Ltd; Artsonig Pty Ltd* [2018] NSWSC 3	Over 80% by value of the syndicated finance debt and approximately 80% of the PIK notes.[355]
12.	2018	Quintis Ltd	A$250 million	Finance debt – senior secured notes	Deleveraging scheme (accompanied by DOCA)	No (Company in administration)	**First court hearing** *Re Quintis Ltd (subject to deed of company arrangement) (recs and mgrs apptd)* [2018] FCA 1510 **Final court hearing** *Re Quintis Ltd (subject to deed of company arrangement) (recs and mgrs apptd)* [2018] FCA 1510	No RSA as the scheme was to be implemented together with an interconditional DOCA which creditors had voted in favour of.[356]

355 *In the matter of BIS Finance Pty Limited; In the matter of Artsonig Pty Limited* [2017] NSWSC 1713, [15]–[16].

356 Explanatory Statement in respect of the "Quintis Ltd" Scheme, 5.3 'The Scheme Proposal' and 5.8 'Deed of Company Arrangement'.

13.	2018	Wiggins Island Coal Export Terminal Pty Ltd	US$3 billion	Finance debt – syndicated	Debt extension / rollover scheme	No	**First court hearing** *Re Wiggins Island Coal Export Terminal Pty Ltd* [2018] NSWSC 1342 **Final court hearing** *Re Wiggins Island Coal Export Terminal Pty Ltd* [2018] NSWSC 1434	Senior RSD executed by 18 out of 23 of the Senior Financiers representing in excess of 90% in value of the Senior Debt.[357] No arrangement with Junior Financiers or Subordinated Financiers.
14.	2019	Wiggins Island Coal Export Terminal Pty Ltd	US$450 million	Finance debt – junior GiLT notes	Debt extension / rollover scheme	No	**Single judgment for first court hearing and final court hearing** *Re Wiggins Island Coal Export Terminal Pty Ltd* [2019] NSWSC 831	Thirteen out of fourteen Junior Financiers holding approximately 86.5% in value of the Junior Debt.[358]
15.	2020	Tiger Resources Ltd	US$247 million	Finance debt – club and bilateral facilities	Deleveraging scheme (including debt for equity swap)	No	**First court hearing** *Re Tiger Resources Ltd* [2019] FCA 2186 **Final court hearing**	An "expectation" of more than 75% in value and 50% by number will support the Scheme. Two of the three senior

357 Explanatory Statement in respect of the "Wiggins Island Coal Export Terminal Pty Limited" 2018 Scheme, 3.8 'Support for the Senior Scheme'.

358 Explanatory Statement in respect of the "Wiggins Island Coal Export Terminal Pty Limited" 2018 Scheme, 3.10 'Support for the Junior Scheme'.

							Re Tiger Resources Ltd (No 2) [2020] FCA 266	lenders that constitute the Scheme Creditors confirmed their support.[359]
16.	2020	Wollongong Coal Ltd; Jindal Steel & Coal (Australia) Pty Ltd	US$347 million	Finance debt – syndicated	Debt extension / rollover scheme	No	**First court hearing** *Re Wollongong Coal Ltd; Jindal Steel & Power (Australia) Pty Ltd* [2020] NSWSC 614 **Final court hearing** *Re Wollongong Coal Ltd; Jindal Steel & Power (Australia) Pty Ltd* [2020] NSWSC 73	78.94% by value of the Axis Facility and all creditors under the SBI facility.
17.	2020	Bell Group Finance Pty Ltd (in liq)	AUD$1.6 billion[360]	All unsecured creditors	Liquidation distribution scheme	No (Company in liquidation)	**First court hearing** *Re Bell Group Finance Pty Ltd (in liq); Ex parte Bell Group Finance Pty Ltd (in liq)* [2020] WASC 287 (unreported) **Final courter hearing** *Re Bell Group Finance Pty Ltd (in*	N/A

[359] Explanatory Statement in respect of the "Tiger Resources Limited" Scheme, 4.6 'Support for the Scheme'.

[360] This amount represents the value of distributions available to be made by the liquidators of the Bell Group.

							liq); Ex parte Bell Group Finance Pty Ltd (in liq) [No 2] [2020] WASC 323	
18.	2020	Ovato Print Pty Ltd	AUD$107.6 million[361]	Unsecured debts – trade creditors Unsecured debts – amounts owed to commissioners of taxation	Deleveraging scheme	Yes (Moratorium order obtained at first court hearing)	**First court hearing** *Re Ovato Print Pty Ltd* [2020] NSWSC 1683 **Final court hearing** *Re Ovato Print Pty Ltd* [2020] NSWSC 1882	N/A as no finance debt subject to the scheme.
19.	2021	Boart Longyear Ltd	US$795 million	Finance debt – New York law governed senior secured term loans and notes Finance debt – unsecured interest on New York law governed senior secured term loans and notes, and New York law governed unsecured notes	Deleveraging scheme (including debt for equity swap)	Yes (Moratorium order obtained at first court hearing)	**First Court hearing** *Re Boart Longyear Ltd* [2021] NSWSC 982 **Final court Hearing** Scheme yet to be sanctioned at the time of writing	99.8% by value of the Secured Debt and 98.1% by value of the Unsecured Debt[362]

[361] This amount represents the face value of debts compromised as part of the broader Ovato restructure, as the amounts owing to the state Commissioners of Taxation and to trade creditors are not disclosed in the Ovato Print Pty Ltd scheme materials.

[362] Explanatory Statement in respect of the 2021 "Boart Longyear Limited" Scheme, 5.1 'Restructuring Support Agreement'.

Metric	Value
Total number of creditors' schemes of arrangement 2008–2021	19
Average number of creditors' schemes of arrangement per year	1.46
Face value of debts subject to creditors' schemes of arrangement — range	$107.6 million – $3.44 billion
Face value of debts subject to creditors' schemes of arrangement — median	$740 million
Number of creditors' schemes of arrangement relating only to finance debt	12 (63.16%)
Number of creditors' schemes of arrangement affecting trade debt	7 (36.84%)
Number of deleveraging creditors' schemes of arrangement	10 (52.63%)
Number of debt rescheduling creditors' schemes of arrangement	5 (26.32%)
Number of liquidation distribution creditors' schemes of arrangement	4 (21.05%)
Number of creditors' schemes of arrangement featuring section 411(16) moratorium orders	3 (15.79%)
Number of creditors' schemes of arrangement without section 411(16) moratorium orders	16 (84.21%)

Singapore's new "supercharged" scheme of arrangement

Paul Apáthy *and* ***Emmanuel Chua*** *HERBERT SMITH FREEHILLS*

Introduction

While the Australian insolvency community grapples with the implementation of the Insolvency Law Reform Act 2016 (Cth), the Government of Singapore is engaged in a law reform project that is much more ambitious in scope.

Singapore is seeking to become an international debt restructuring hub, akin to London or New York, an aspiration unambiguously conveyed in the title of the *Report of the Committee to Strengthen Singapore as an International Centre for Debt Restructuring*[1] released on 20 April 2016 (the 2016 Report). The 2016 Report recommended that this be achieved by:[2]

- enhancing Singapore's legal framework for restructuring;
- creating a restructuring-friendly ecosystem;[3] and
- addressing the "perception gap".[4]

A key aspect of these recommendations has now been implemented, with the Singapore Parliament passing the Companies (Amendment) Act 2017 (SG) (the Act) which amends Singapore's Companies Act (Cap 50) 2006 (Companies Act).[5] The Act introduces sweeping changes to Singapore's restructuring and insolvency framework, including significant amendments relating to schemes of arrangement, judicial management and cross-border insolvency.

Central to the reforms is the augmentation of the scheme of arrangement process with a number of new provisions, some of which were adopted from the US Bankruptcy Code (1978) (the Bankruptcy Code). This article focuses on this new "supercharged" scheme of arrangement procedure, and its potential use in cross-border restructurings.

Schemes of arrangement

Prior to these law reforms, Singapore schemes of arrangement were very similar to Australian schemes.[6] The Act introduces a number of measures to supercharge Singapore creditor schemes of arrangement including:[7]

- an expanded jurisdiction for foreign companies to access Singapore schemes;
- enhanced moratoriums (including a "world-wide" stay and extension of the moratorium to related companies);
- (cross-class) creditor cram downs;
- "pre-packaged" schemes that bypass the requirement for scheme meetings;
- priority rescue funding;
- a formal proof of debt regime; and
- various other creditor protections.

The Singapore scheme of arrangement regime has not been meaningfully updated since its introduction over 100 years ago.[8] These changes are therefore nothing short of revolutionary. Many of these new provisions are based on concepts found in Ch 11 of the Bankruptcy Code. By adopting these concepts, Singapore is seeking to create a new regime that incorporates the "best of both worlds" of the scheme of arrangement and Ch 11 procedures.[9]

Use of Singapore schemes in respect of foreign companies

Key to becoming an international debt restructuring hub is enabling foreign companies to avail themselves of Singapore's scheme of arrangement procedure.

A scheme of arrangement may be proposed in respect of any "company", which means in this context any corporation liable to be wound up under the Companies Act.[10] The Act has expanded this concept by specifically providing that a foreign company may (only) be wound up in Singapore if it has a "substantial connection" with Singapore.[11]

A court may rely on the presence of one or more of the following matters in determining that the company has a substantial connection with Singapore:[12]

- Singapore is the centre of main interests of the company;
- the company is carrying on business in Singapore or has a place of business in Singapore;
- the company is a foreign company that is registered under Div 2 of Pt XI of the Companies Act;
- the company has substantial assets in Singapore;

- the company has chosen Singapore governing law for a loan or other transaction (or for the resolution of a dispute arising out of a loan or other transaction); or
- the company has submitted to Singapore's jurisdiction for the resolution of a dispute relating to a loan or other transaction.

The substantial connection concept appears to be a development of the "sufficient connection" test applied by the English courts when determining if there is jurisdiction to wind up a foreign company in England, and which also forms the basis for jurisdiction in respect of schemes of arrangement.[13] The English courts have developed this test in the context of schemes of arrangements to facilitate the use of English schemes to restructure European and other foreign companies, relying on many of the sorts of matters contemplated above.[14]

Enhanced moratoriums[15]

The Act provides that where a company proposes, or intends to propose, a scheme of arrangement, the court may, on the application of the scheme company, grant a moratorium order.

The company must provide specific information in support of such application, including evidence of support from the company's creditors for the scheme of arrangement and an explanation of how such support would be important for the success of the scheme.[16]

The scope of the moratorium order is potentially very broad[17] — it may restrain:[18]

- winding up resolutions;
- appointment of receivers;
- legal proceedings against the company;
- execution, distress or other legal process against property of the company;
- any step to enforce any security over any property of the company, or to repossess any goods held under lease, hire-purchase or retention of title arrangements; and
- re-entry or forfeiture under any lease in respect of property occupied by the company.

The moratorium order may be expressed to apply to acts outside of Singapore (provided the relevant person is within the jurisdiction of the Singapore court).[19] This is similar in concept to the "world-wide" automatic stay,[20] provided for under Ch 11 of the Bankruptcy Code, which has extraterritorial reach through the personal jurisdiction of the US bankruptcy courts that can extend to acts outside of the US.

Moratorium orders may also be granted by the Singapore court with respect to a holding or subsidiary company of the scheme company, where:[21]

- the related company plays a necessary and integral role in the scheme;
- the scheme will be frustrated if a restrained action is taken against the related company; and
- the creditors of the related company will not be unfairly prejudiced by the order.

Remarkably, it appears the related company may be a foreign company without a substantial connection to Singapore.[22]

The most obvious use would be to obtain protection not only for a borrower, but also all of the guarantors of debt subject to the scheme. However, there may well be more creative applications of a "group moratorium" order. The moratorium could therefore be a powerful tool to assist with multi-national group restructurings (that goes even beyond what is normally available in Ch 11 of the Bankruptcy Code).

However, the Singapore courts will need to be vigilant that these moratoriums do not become too easily accessible or abused by debtors — merely intending to propose a scheme is a low bar, and there are no limits on the period for which the courts may grant moratorium orders.

The Act also introduces an automatic 30-day moratorium, in respect of the scheme company itself, which runs from the date that the application is made for a moratorium order.[23]

Cross-class creditor cram downs

The Act creates a mechanism to force one or more non-consenting classes of creditors to be bound by the scheme of arrangement, if:[24]

- the scheme is approved by a majority in number, representing at least 75% of the value, of those present and voting at the meeting of at least one class of creditors;
- the scheme is also approved by creditors comprising a majority in number, representing at least 75% of the value, of those present and voting at the meeting(s) of scheme creditors as a whole; and
- the scheme is "fair and equitable" to each dissenting class of creditors and does not "discriminate unfairly" between two or more classes of creditors.

The concept of "fair and equitable" has been adopted from the Bankruptcy Code,[25] and requires that:[26]

- no creditor in the dissenting class receive less under the scheme than it is estimated by the court to receive in the most likely scenario if the scheme is not passed;

- if the creditors in the dissenting class are secured, they must receive deferred cash payments totalling the amount secured (and security preserved until such time), be given a charge over the proceeds of their secured asset, or be entitled to realise the "indubitable equivalent" of the security; and
- if the creditors in the dissenting class are unsecured, they must either be paid out in full, or the scheme must not provide for any creditor or shareholder subordinate to the dissenting creditor to receive or retain any property.

In principle, this cross-class cram down mechanism addresses a key weakness of the scheme of arrangement procedure.[27] While the requisite majority of creditors can bind the minority within a class, if the rights of creditors are sufficiently dissimilar, they will need to form a separate class.[28] In practice, this can create a veto for junior classes of creditors, unless an alternative mechanism can be employed to "burn them off".[29]

However, the Singapore cram down mechanism may be difficult to utilise as drafted. The Act incorporates (as described in the last bullet above) what is known in the US as the "absolute priority rule".[30] This rule requires (among other things) that to cram down an unsecured creditor, existing shareholders may not retain any of their shares in the company (unless all unsecured creditors are paid in full). The rule effectively requires the shares of existing shareholders to be divested (subject to the availability of certain exceptions),[31] a power which is provided for in the Bankruptcy Code by way of a shareholder cram down power.[32] Unfortunately, no such general power to cram down shareholders (or otherwise divest their shareholding in the company) exists under the Act or existing Singapore law. Effectively, therefore, it appears the Singapore cram down may rely on shareholders agreeing to *voluntarily* divest their shares for no value (or the availability of enforcement mechanics to "burn off" shareholders).[33]

Pre-packaged schemes

The Act introduces the concept of "pre-packaged schemes". The court may, on the application of the company, make an order approving a creditor scheme of arrangement even though no meeting of creditors (or class thereof) has been ordered or held.[34]

Creditors intended to be bound by the scheme must be notified of the application, and provided a statement that contains:[35]

- information concerning the company's property and financial prospects;
- information on how the proposed scheme will affect the rights of those creditors; and
- such other information as is necessary to enable the creditor to make an informed decision whether to approve the proposed scheme.

The court may not approve the scheme unless it is satisfied that, had a meeting of the (relevant) creditors been summoned, creditors comprising a majority in number, representing at least 75% of the value, of those present and voting at the meeting of each relevant class, would have approved the scheme. The Act does not specify what evidence would be required to demonstrate to the court that the scheme would have been approved. However, it could be expected that scheme voting or lock-up agreements signed by the requisite majorities would be an appropriate basis to draw this conclusion.[36]

It should be noted that the pre-packaged scheme mechanic cannot be used in conjunction with the cross-class cram down provisions.[37]

This provision helps address a common criticism of schemes of arrangement; that they can be expensive and lengthy processes. The provision effectively allows a company to dispense with both the court hearing to convene a meeting of creditors, and the meeting itself, if it can be demonstrated that the outcome of the meeting is a forgone conclusion. This efficiency is to be welcomed.

Priority rescue funding

Another concept adopted from Ch 11 of the Bankruptcy Code is a regime for the company to access "debtor-in-possession" priority funding during the scheme process.[38]

Where a company has made an application to convene a scheme meeting of creditors or to obtain a moratorium order, the company may make a further application to the court to seek priority treatment of "rescue financing" obtained by the company.[39] The company must send a notice of the application to each creditor of the company.[40]

To qualify as rescue financing, the financing must be necessary:[41]

- for the survival of the company (or of the whole or any part of the undertaking of the company) as a going concern; or
- to achieve a more advantageous realisation of the assets of the company than on a winding up.

The court may grant orders bestowing a number of tiers of priority treatment in respect of debt arising from the rescue financing, as follows:[42]

- that the debt be treated as if it was part of the costs and expenses of the winding up;
- that the debt has priority over preferential debts. This order may only be granted if the company

would not have been able to obtain the rescue financing from any person without such security;

- that the debt be secured by a security interest on property of the company that is not otherwise subject to any security interest, or a subordinate security interest on property of the company that is subject to an existing security interest. This order may only be granted if the company would not have been able to obtain the rescue financing from any person without such security; and
- that the debt be secured by a security interest on property of the company that is subject to an existing security interest, of the same priority as or a higher priority than the existing security interest. This order may only be granted if:
  - — the company would not have been able to obtain the rescue financing from any person without such security; and
  - — there is "adequate protection" for the interests of the holder of the existing security interest.

The last of these tiers effectively allows the granting of "super-priority" security over all existing creditors. This is subject to the requirement of adequate protection for existing security interests, which can be achieved by the court:

- ordering the company to make one or more cash payments to the security holder, the total amount of which is sufficient to compensate the holder for any decrease in the value of the holder's existing security interest;
- ordering the company to provide the holder additional or replacement security of a value sufficient to compensate the holder for any decrease in the value of the holder's existing security interest; or
- granting any relief that will result in the realisation by the holder of the indubitable equivalent of the holder's existing security interest.

It will remain to be seen how effective or necessary this regime is in practice. Unlike the court-supervised Ch 11 regime, there is no general requirement under Singapore (or Australian) law for a company that has proposed a scheme of arrangement to seek court approval to obtain finance or grant security. Therefore the main benefit of this provision will be to allow new finance to be afforded a priority that cannot be achieved consensually in the normal manner.

It is not clear how frequently such cases will actually arise. Where credit is being provided by a creditor with existing security over all assets of the company, or where there is no such security already in existence, the debt can be secured consensually. However, where rescue funding is proposed to be provided by a third party, and there is an existing creditor with security over all of the company's assets, the value of which is insufficient to meet its claim, it could be difficult to provide adequate protection to that existing creditor.[43] Conversely, if the lack of critical funding may result in a liquidation of the company, this could have a major detrimental impact on the value of an existing secured creditor's collateral.

The provision does not expressly address the effect of contractual restrictions on the company, or between creditors, restricting the incurrence of debt or granting of security by the company. Such provisions are common in finance documents (eg, negative pledge and debt incurrence covenants), security and intercreditor agreements. Arguably the new provision could be regarded as permitting the court to override such contractual restrictions, but it remains to be seen how the Singapore courts will approach this issue.[44]

A further complication arises where this mechanic is being used in cross-border restructurings. The Singapore court would be unable to grant priority status in respect of the enforcement of foreign security or in respect of foreign insolvency processes. This will reduce the utility of this provision where the scheme company has significant assets in other jurisdictions (either directly or through foreign subsidiaries).

Formal proof of debt regime

The Act sets out a detailed and formal proof of debt process for creditor schemes.[45] This new process appears focused on determining creditor claims for voting rather than dividend purposes.

Where a meeting of creditors is summoned, the Act requires that creditors are notified of the manner and period within which to file proofs of debt.[46] Failure to comply with these requirements will disallow a creditor from voting at the meeting.

Once a creditor has filed a proof of debt they are entitled to inspect another creditor's proof of debt, and to object to:

- the rejection of its proof of debt;
- the admission of another creditor's proof of debt; or
- a request by another creditor to inspect its proof of debt.

Every proof of debt is to be adjudicated by the court-appointed chairman of the meeting.[47] If there is any dispute in respect of the inspection, admission or rejection of any proof of debt, such dispute is to be determined by an "independent assessor".[48] If a party to the dispute disagrees with the determination of the

independent assessor, that person may file a "notice of disagreement" for the court to consider that dispute when the court hears the application for approval of the scheme.[49]

Previously there was no formal statutory process for determining creditor claims in schemes of arrangement. Where the issue arose in practice, it was typically dealt with in two stages:[50]

- the chairman of the creditors' meeting had the power to admit disputed or unliquidated claims for voting purposes at a value determined by the chairman; and
- the terms of the scheme itself could provide a mechanism for assessing the nature of claims with uncertain values (such as assessment by an adjudicator) for the purposes of dividends under the scheme.

In practice however, in the case of schemes that are restructuring financial debt, it is unusual for there to be any significant disagreement as to its quantum.

These provisions in the Act appear to be a response to the Singapore case of *Royal Bank of Scotland NV (formerly known as ABN Amro Bank NV) v TT International Ltd*[51] (*TT International*). In that case a creditor scheme was passed by a "razor thin margin" of creditors, and there were allegations that the scheme chairman (also the proposed scheme manager) had made inappropriate decisions to allow and disallow various creditor claims which influenced the outcome. While the Singapore Court of Appeal made a number of helpful statements in that case as to proper practice, the Insolvency Law Review Committee formed the view that there should nevertheless be a formal legislative framework for determining proofs of debt in schemes.[52]

Given the new provisions focus on the determination of proofs of debt for voting purposes, arguably it would still be permissible for the scheme documentation to provide for claim determination mechanics for dividend purposes.

There is a risk that this more formal proof of debt regime, including the ability of creditors to contest each other's claims, could in some cases protract the scheme timetable if it requires all proof of debt-related disputes to be determined by the independent assessor prior to the scheme meeting.[53]

Foreign recognition of Singapore schemes

A key aspect of whether these law reforms will be effective is whether a Singapore scheme of arrangement will be recognised and given effect to in those foreign jurisdictions where dissenting creditors might seek to enforce their debt or security claims subject to the scheme.

The rule in *Gibbs* (named after the eponymous 1890 case *Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux*[54] (*Gibbs*)) may be a barrier to recognition.[55] *Gibbs* is an English Court of Appeal decision that held that a debt may only be discharged by the governing law of that debt. This is a significant barrier for the recognition in England of a Singapore scheme that seeks to compromise English law-governed loans or bonds. This is problematic given the prevalence of the use of English law in international finance. Furthermore, the *Gibbs* rule is also likely to apply in a number of other common law jurisdictions.[56]

Having said that, the rule in *Gibbs* has attracted criticism of late,[57] including in the recent Singapore case of *Pacific Andes Resources Development Ltd*.[58] It is therefore possible that common law jurisdictions may move towards a willingness to recognise a debt discharge in accordance with the law of the debtor's centre of main interests (even when the debt itself is not governed by that law).[59]

The United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law) is also an important consideration. The Model Law has been adopted in a number of key jurisdictions around the world, and allows courts in those jurisdictions to recognise a "foreign proceeding" and provide various forms of assistance (including recognising the effectiveness of a discharge of debt under that foreign proceeding).

However, it is not clear that a Singapore scheme of arrangement is a "foreign proceeding"[60] for these purposes because, among other things, it is arguably not an insolvency process. However, the position will depend on how the Model Law is implemented in each relevant country. The US has adopted a broad concept of a foreign proceeding in Ch 15 of the Bankruptcy Code (its implementation of the Model Law),[61] under which US courts have regularly been willing to recognise and give effect to English schemes of arrangement that compromise or discharge New York law-governed debt, where it can be demonstrated that the "centre of main interests" of the debtor company is in the UK.[62]

Singapore as a debt restructuring hub

Singapore has already been successful in establishing itself as an arbitration hub and now seeks to compete with London and New York as an international centre for debt restructuring.

There are a number of factors that act in Singapore's favour. The new "supercharged" Singapore scheme of arrangement procedure established by the Act introduces a lot of the powerful tools of the Ch 11 process (as outlined above), but still retains much of the relative flexibility, speed and cost efficiency of the scheme of

arrangement procedure that has made it such a popular tool for cross-border restructurings. While there remain some potential issues with the new legislation (some of which are noted above), Singapore has demonstrated an ability to quickly legislate where required. It can therefore be expected that should any significant problems emerge in practice with the new legislation, they will be resolved reasonably swiftly.

In addition, Singapore has already established itself as an important financial and professional services hub for Asia. Its proximity to and central role in the region makes it a natural venue for South East Asian restructurings. It also has the advantage of an English-derived common law legal system that is well-understood, and a well-regarded judiciary.

Whether it can become a true global player will, however, depend in part on the ability of Singapore to attract international restructuring professionals to the jurisdiction, and the development of a sophisticated "ecosystem". Also of critical importance will be the extent to which Singapore debt restructurings are accepted and recognised in other key jurisdictions.

Lessons for Australia

Singapore's reforms demonstrate how much potential there is for improvement of Australia's own restructuring and insolvency regime. Reform in Australia, by contrast to Singapore, has been both slow and relatively timid. We hope that Singapore's example may inspire the Australian Government to return to the question of restructuring law reform with renewed vigour.

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Footnotes

1. Committee to Strengthen Singapore as an International Centre for Debt Restructuring *Report of the Committee* Report Paper (20 April 2016) www.mlaw.gov.sg/content/dam/minlaw/corp/News/Report%20of%20the%20Committee.pdf.
2. Above n 1, p 6.
3. The 2016 Report uses this phrase to refer to increasing the availability of rescue financing in Singapore and strengthening the quality of insolvency professionals based in Singapore through further education and training. Above n 1, p 20.
4. The 2016 Report uses this phrase to refer to communicating the benefits of debt restructuring in Singapore to a wider audience and Singapore professionals, judges and academics increasing their involvement in international organisations, conferences and research. Above n 1, p 23.
5. Particularly striking is the speed with which Singapore has enacted these reforms. The period between the announcement of a public consultation on draft legislation and passing of the Act by parliament was less than 5 months. As of the date of writing this article the Act's commencement date has not been formally gazetted.
6. Companies Act (Cap 50) 2006 (SG), s 210; and Corporations Act 2001 (Cth), s 411. The regimes in the UK (see Companies Act 2006 (UK), ss 895–99) and Hong Kong (see Companies Ordinance (Cap 622) 2014 (HK), ss 668–77) are also similar.
7. It should be noted that these new provisions only apply in respect of a compromise or arrangement between a company and its *creditors* (or any class thereof). See Companies Act (Cap 50) 2006 (SG), above n 6, new s 211A.
8. The same can also be said for Australia and the UK.
9. See for example the comments of Judicial Commissioner Kannan Ramesh recorded in a recent roundtable hosted by Global Restructuring Review: K Karadelis "International debt restructuring: can other jurisdictions compete with London and New York?" (1 March 2017) http://globalrestructuringreview.com/article/1129318/international-debt-restructuring-can-other-jurisdictions-compete-with-london-and-new-york.
10. Companies Act (Cap 50) 2006 (SG), above n 6, s 210(11).
11. Companies Act (Cap 50) 2006 (SG), above n 6, new s 351(1)(d).
12. Companies Act (Cap 50) 2006 (SG), above n 6, new s 351(2A).
13. Companies Act 2006 (UK), s 895(2)(b); *Re Drax Holdings Ltd; Re InPower Ltd* [2004] 1 WLR 1049. This concept has also been accepted in Singapore, see *Re Griffin Securities Corp* [1999] 1 SLR(R) 219.
14. See for example *Re Metinvest BV* [2017] EWHC 178 (Ch) [21]–[22] (English law notes and "significant number" of English domiciled noteholders); *Re Codere Finance (UK) Ltd* [2015] EWHC 3778 (Ch) (the company's centre of main interests was England, 97% of the noteholders (by value) submitted to the jurisdiction of the English court and the company was incorporated in England); *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch) (company's centre of main interests was England); and *Re Vietnam Shipbuilding Industry Groups* [2013] EWHC 2476 (Ch) (loan agreement governed by English law which conferred non-exclusive jurisdiction on the English courts).
15. These moratoriums have been described as "enhanced" as there is an existing, fairly limited, ability under s 211(10) of the Companies Act to restrain further proceedings in any action or proceeding against the company except with the leave of the court. There is a similar provision in s 411(16) of the Corporations Act.

16. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211(B)(4). The company must also provide a list of every secured creditor and the 20 largest unsecured creditors of the company, and (if the scheme has not yet been proposed) a brief description of the intended scheme which is sufficient to enable the court to assess whether the intended scheme is feasible and merits consideration by the company's creditors.
17. Notwithstanding this, the Singapore Ministry of Law has indicated that the intention is that "a moratorium order should be scoped appropriately and it should not generally restrict creditors who are not subject to the proposed scheme": Singapore Ministry of Law "Ministry's response to feedback from public consultation on the Draft Companies (Amendment) Bill 2017 to Strengthen Singapore and an International Centre for Debt Restructuring" Response Paper (27 February 2017) [3.1.10] www.mlaw.gov.sg/content/dam/minlaw/corp/News/Annex%20A%20-%20Goverment%20Response%20to%20Public%20Consult%20Feedback%20for%20Companies%20Act%20Amendments.pdf.
18. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211B(1).
19. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211B(5)(b).
20. US Bankruptcy Code 1978 11 USC § 362(a).
21. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211C. This order may also be granted in respect of acts outside of Singapore. This order may not, however, apply to members of the corporate group that are not holding or subsidiary companies. See Response Paper, above n 17, at [4.1.3].
22. Response Paper, above n 17, at [4.1.4].
23. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211B(8) and (13). This interim moratorium is available to a company only once within any 12-month period, and applies only to acts within Singapore. The interim moratorium ceases 30 days after the application for court approval of a scheme of arrangement is made (or the date on which the application is decided on by the court, if this date is earlier than 30 days).
24. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211H(1)–(3).
25. Above n 20, § 1129.
26. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211H(4)(b)(i)–(ii).
27. See generally G O'Dea "Craving a cram-down: why English insolvency law needs reforming" (2009) 24(10) *Journal of International Banking and Financial Law* 583.
28. See *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241; and *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573.
29. One common mechanism adopted in European restructurings is the combination of an English pre-packaged administration "topco" sale to "burn off" junior creditors (utilising intercreditor release mechanics) and an English scheme of arrangement to bind senior creditors to a debt roll to the "newco" purchaser. This structure was examined by the English court in *Re Bluebrook Ltd* [2009] EWHC 2114 (Ch).
30. Above n 20, § 1129(b)(2)(B).
31. The US courts have developed the doctrines of "new value" and "gifting" which can allow a degree of circumvention of the absolute priority rule, although the scope and availability of these doctrines is subject to some debate.
32. Above n 20, § 1129. See also discussion in *Bank of America National Trust and Savings Association v 203 North LaSalle Street Partnership* 526 US 434 (1999).
33. This problem has increased relevance as the term "unsecured creditor" for the purposes of Companies Act (Cap 50) 2006 (SG), above n 6, new s 211H(4)(b)(ii) includes secured creditors to the extent of any shortfall claim that cannot be satisfied from their secured collateral.
34. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211I(1).
35. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211I(3).
36. Voting or lock-up agreements are a common mechanic used to ensure that there is sufficient creditor support to result in the scheme being passed before the company makes the formal application to convene meetings to vote on a scheme. The use of lock-up agreements has been considered by the English courts in cases such as *Primacom Holding GmbH v A Group of the Senior Leaders and Credit Agricole* [2011] EWHC 3746 (Ch); and *Re Seat Pagine Gialle Spa* [2012] EWHC 3686 (Ch).
37. Response Paper, above n 17, at [9.3.1].
38. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211E. This provision draws on concepts contained in s 364 of the Bankruptcy Code.
39. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211E(1).
40. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211E(2).
41. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211E(9).
42. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211E(1).
43. Such new first ranking debt is risks lowering the amount recoverable by the existing secured creditor from the secured assets. This is especially the case where the new debt is funding working capital requirements or trading losses, and therefore does not generate significant new tangible assets to expand the security pool (and thereby offset the new first ranking debt).
44. This issue was not addressed in the Response Paper.
45. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211F.
46. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211F(1) and 211F(3).
47. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211F(5).
48. The independent assessor is appointed either by agreement of all parties to the dispute, or by the court (upon application by any party to the dispute or the company). See Companies Act (Cap 50) 2006 (SG), above n 6, new s 211F(9)(b).
49. Companies Act (Cap 50) 2006 (SG), above n 6, new s 211F(10).
50. See for example the discussion in *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621 (Ch).
51. *Royal Bank of Scotland NV (formerly known as ABN Amro Bank NV) v TT International Ltd* [2012] SGCA 9.
52. Singapore Insolvency Law Review Committee *Final Report* (2013) 144 www.mlaw.gov.sg/content/dam/minlaw/corp/News/Revised%20Report%20of%20the%20Insolvency%20Law%20Review%20Committee.pdf.
53. The concept of permitting creditors to inspect and contest each other's proofs of debt exists in Ch 11 of the Bankruptcy Code. However Ch 11 is a full and formal insolvency process which (typically) has longer time frames to address and adjudicate disputes prior to creditors voting on, and receiving dividends under, the plan.

54. *Gibbs & Sons v La Societe Industrielle et Commerciale des Metaux* (1890) 25 QBD 399.
55. The rule gets its name from one of the (though not the first) applications of the rule. See above n 54; and R Mokal "Shopping and scheming, and the rule in Gibbs" (2017) *South Square Digest* (March 2017) 58–63.
56. For example see *Hong Kong Institute of Education v Aoki Corp* [2004] 2 HKLRD 760. The position in Australia is less certain. See *Re Bulong Nickel Pty Ltd* (2002) 26 WAR 466; (2003) 21 ACLC 191; [2002] WASC 226; BC200205474; and *Re Glencore Nickel Pty Ltd* (2003) 44 ACSR 210; [2003] WASC 18; BC200300179. The US does not apply the rule in *Gibbs* (see *Oui Financing LLC v Deller and Oui Management SAS* 2013 WL 5568732 (SDNY 9 October 2013).
57. For example see *Global Distressed Alpha Fund 1 Ltd Partnership v PT Bakrie Investindo* [2011] EWHC 256 (Comm) at [28]; see also Judicial Commissioner K Ramesh (writing extra-judicially) "The Gibbs principle: a tether on the feet of good forum shopping" *Singapore Academy of Law Journal* (forthcoming); and Mokal, above n 55, at 58–63.
58. *Pacific Andes Resources Development Ltd* [2016] SGHC 210.
59. This may be appropriate, as the rule in *Gibbs* has been subject to strident criticism specifically in the context of the Model Law. See L Chan Ho *Cross Border Insolvency: Principles and Practice* Thomson Reuters, 2016 p 169: "Gibbs cannot survive the British Model Law because they are philosophically incompatible and practically irreconcilable."See also Mokal, above n 55, at 58–63.
60. The Model Law defines "foreign proceeding" as:

> … a collective or judicial proceeding in a foreign State, including an interim proceeding, pursuant to a law relating to insolvency in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation.

UNCITRAL Model Law on Cross Border Insolvency, Art 2(a).

61. See the definition of "foreign proceeding" in Bankruptcy Code, above n 20 § 101(23), which includes a reference to a proceeding relating to "adjustment of debt".
62. For example, see *In re Castle Holdco 4 Ltd* No 09–11761 (REG) (Bankr SDNY 7 May 2009); and *In re Magyar Telecom BV,* No 13–13508 (SHL) (Bankr SDNY 11 December 2013).

12 October 2020

Manager
Market Conduct Division
Treasury
Langton Cres
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Email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam,

Corporations Amendment (Corporate Insolvency Reforms) Bill 2020
TMA Australia Submissions on the Exposure Draft

Turnaround and restructuring naturally lie at the heart of the Turnaround Management Association ("TMA") Australia. That is why, with Australia facing a pandemic induced recession through no fault of its own, the TMA supports SME law reform which promotes restructuring of businesses facing insolvency through no fault of their own.

Consistent with our engagement with Treasury since the onset of COVID-19, the TMA has put in a huge amount of work and thought into our response. The submission is considered, detailed and solution focussed. The critical themes are:

- A restructuring practitioner should personify and be true to the chosen description. Submission 36 sets out our rationale and the appendixes provide an analytical framework to assist in the definition of suitably qualified restructuring professionals.
- To survive during a debtor-led restructuring process, the debtor will need the support of its trade and finance creditors. The priority of debts incurred during this period need to be certain and clear. Submissions 17, 19 and 40 address the central issues of priority of debts incurred.

There is a lot left to regulation – including how best to balance between protection of employee entitlements and keeping alive the prospect of ongoing employment. The TMA commits to working with you and other bodies such as the Australian Institute of Company Directors and the Business Council of Australia to make the reform work as intended.

The work will not end with legislative drafting. Clear, easy to use online guides and precedents will be essential to the bring the reform to life. This is particularly important given the focus on helping financially distressed small business to help themselves. The TMA and its members will help to develop the material required to make the reform work in practice.

As we move to a new generation of restructuring and insolvency law reform, it was particularly encouraging to see young members working into the early hours of the morning together with established board members to craft the submission. They are named below as part of our team which has worked on the submission and will keep on working on these and other reforms to make our turnaround, restructuring and insolvency frameworks as best as they can be to meet the economic challenges posed by COVID-19.

- Paul Apathy, TMA Australia Director (Partner, Herbert Smith Freehills)
- Jacob Lancaster (Herbert Smith Freehills)
- Hongbei Li (Herbert Smith Freehills)
- Angus Dick (Herbert Smith Freehills)

- Jennifer Ball, TMA Australia Director (Partner, Clayton Utz)
- Alexandra McCulloch (Clayton Utz)
- Michael Sloan, TMA Australia Director (Partner, Ashurst Australia)
- Gayle Dickerson, TMA Australia Director (Partner, KPMG)
- Sam Marsden, TMA Australia Director (Partner, Deloitte)
- Jane Starkins, TMA Australia Director (State General Manager VIC, Scottish Pacific)

Sincerely,

Carl Gunther
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1 General Comments

The TMA welcomes the opportunity to comment on the Exposure Draft of the *Corporations Amendment (Corporate Insolvency Reforms) Bill 2020* (**Exposure Draft**).

1.1 Focus of TMA submissions

The TMA has in large part confined the scope of these submissions to the proposals pertaining to the restructuring of small businesses contained in Schedules 1 and 2 of the Exposure Draft. These aspects are most central to the role and expertise of the TMA as an organisation focussed on restructuring and turnaround.

We have given some limited consideration to Schedule 3 (Simplified liquidations) of the Exposure Draft. This is mainly in the context of considering the means by which the restructuring procedures can transition to simplified liquidation. In the limited time available we have not reviewed or commented on Schedule 4 (Virtual meetings and electronic communications).

The TMA welcomes the Government's moves to introduce simplified restructuring processes for small businesses. The TMA is therefore generally supportive of these reforms. The TMA's comments in these submissions are therefore focussed on suggestions which we believe may help these reforms work successfully. Our commentary is based on the TMA's preference for finding a way to revive ailing businesses and avoiding their demise given the terrible and lasting impact that has.

1.2 Comments on consultation period and materials

We do note that a significant part of the substance of the reforms (rather than simply administrative detail) appears to be dealt with in forthcoming regulations (the **Regulations**). We understand that this approach is driven by the Government's desire to bring these reforms into effect by 1 January 2021 and the limited Parliamentary sitting time before then.

However, given the Regulations are yet to be released, there are some challenges in understanding the operation of these proposed laws as a whole. The consultation period for this legislation is very short for legislation making changes of this magnitude to Australia's restructuring and insolvency landscape.

It is therefore likely that the Exposure Draft gives rise to a number of effects, consequences and interactions that the TMA has not been able to ascertain or fully consider at this stage. We therefore recommend that this legislation is formally reviewed after a period in operation so that it can be further considered, and where appropriate amended, with the benefit of this further experience in practice.

1.3 Key submissions

The TMA has made a significant number of submissions in section 2 of this document. However, we wish to draw your attention to, and emphasise the following submissions in particular:

- Submission 7: Consequences of termination of restructuring period
- Submission 17: Ability to incur debts during restructuring period
- Submission 19: Payment of pre-restructuring debts during restructuring period
- Submission 33: Proposing a restructuring plan – payment of employee entitlements
- Submission 36: Registered liquidator / who can be a restructuring practitioner?
- Submission 40: Treatment of debts incurred in restructuring in a subsequent liquidation

These submissions are shaded in red in the below table.

2 Submissions on the Exposure Draft

	Topic	Proposed new or amended Corporations Act section	Submission
1	**General comments - complexity**	N/A	**Recommendation 1** • Simplify Part 5.3B by removing or simplifying certain provisions to reflect the unique context of a small business under restructuring. • Address key issues in the Corporations Act rather than in the Regulations. The TMA notes that the Exposure Draft incorporates many of the provisions in the *Corporations Act 2001* (Cth) (**Corporations Act**) which apply to voluntary administrations. Many of the key provisions relating to the operation of the restructuring process are to be contained in the Regulations. The result is a statutory regime that appears relatively complex. We are conscious that this complexity may make the regime less accessible for small businesses hoping to utilise this regime. We recommend consideration be given to whether all of the provisions in the Exposure Draft that have been incorporated from the Corporations Act are necessary in the context of the small business restructuring plan, or whether some of these can be removed. It would also be helpful if more of the key provisions that are currently to be dealt with in the Regulations are contained in the statute. We also recommend that the Government devote resources to ensure that there are user-friendly guides and explanations of the process made available on Government websites once these reforms are enacted to assist small businesses navigate these provisions and the regime generally.

	Topic	Proposed new or amended Corporations Act section	Submission
2	**General comments – UNCITRAL draft text on simplified insolvency regime**	N/A	**Recommendation 2** • Have regard to the UNCITRAL Text generally when formulating this legislation. The TMA has reviewed the latest draft text on a simplified insolvency regime prepared by the United Nations General Assembly (available at https://undocs.org/en/A/CN.9/WG.V/WP.170) (**UNCITRAL Text**). Though the UNCITRAL Text is yet to be finalised, the draft provides a useful set of legislative recommendations as to matters that should be covered when enacting laws for a simplified restructuring or liquidation regime for small businesses. These recommendations have been carefully developed by an international group of experts, and reflect some of the leading thinking in this area. We therefore recommend that the Government has regard to the recommendations contained in the UNCITRAL Text when formulating this legislation and designing the restructuring regime and simplified insolvency regime contemplated therein.
3	**Use of the term "restructuring" to describe a specific procedure**	N/A	**Recommendation 3** Replace the following terms in the Exposure Draft: • "restructuring" with "small company moratorium"; and • "restructuring plan" with "small company arrangement". The Exposure Draft uses the term "restructuring" to describe the formal process introduced in Division 2 of the new Part 5.3B. The term "restructuring" has a well-established, more general meaning in normal business usage. Generally the term is used to refer to a process to adjust both the components of the balance sheet and the operations of the business through a series of steps mostly outside of a formal insolvency

	Topic	Proposed new or amended Corporations Act section	Submission
			process. It can also be used more generally to refer to a general reorganising of a corporate group or its business activities. We are concerned that use of the label "restructuring" to refer to a specific formal procedure, as currently envisaged under the Exposure Draft, may lead to a degree of confusion of terminology within the business community (and potentially for small businesses trying to understand the process, and conducting searches using this phrase). We therefore recommend replacing the label "restructuring" with something that will more clearly describe this process. In the United Kingdom a newly enacted debtor-in-possession process with many similarities is called the "moratorium". Likewise Singapore has also introduced a debtor-in-possession "moratorium" procedure. We suggest that a similar label would be more appropriate than "restructuring". We recommend use of the term "small company moratorium" rather than "restructuring". Our proposed label is descriptive of the process, less likely to cause confusion, consistent with internationally similar processes and also reflects that it is a procedure specifically targeted at small companies. Similarly, we recommend using the term "small company arrangement" instead of "restructuring plan". This term would be more consistent with existing terminology both under the Corporations Act, and also with terminology in other jurisdictions such as the United Kingdom.
4	**"Small business restructuring practitioner" terminology**	N/A	**Recommendation 4** • Define or replace references to "small business restructuring practitioner" with "restructuring practitioner" for consistency. The Exposure Draft refers to "small business restructuring practitioner" and "restructuring practitioner" in different places. It is not apparent how these terms interrelate. The definition of "restructuring practitioner" to be inserted at s 9 includes a small business restructuring practitioner, but there does not appear to be a definition for small business restructuring practitioner.

	Topic	Proposed new or amended Corporations Act section	Submission
			Consideration should be given to consistency of drafting and whether any additional definitions are required.
5	**When restructuring procedure ends**	453A(b)	**Recommendation 5** • Specify when a "restructuring" process ends by inserting a provision in the Corporations Act similar to existing s 435C of the Corporations Act in respect of administration (rather than dealing with this in the Regulations). Section 453A(b) of the Exposure Draft provides that a restructuring of a company ends in the circumstances prescribed by the Regulations. We recommend that the circumstances where a restructuring ends should be set out in statute, in a similar way to the existing s 435C of the Corporations Act which specifies the circumstances in which an administration can end. This is important for understanding the restructuring process as a whole, and ensuring it works as intended. Most of the other key matters relating to the restructuring period (as opposed to the period of the restructuring plan) are set out in statute. We are therefore of the view that this should also be contained in the primary legislation rather than in the Regulations. We assume that the restructuring process will end upon the earlier of: • when the prescribed maximum period of time for a restructuring expires; • when terminated by the restructuring practitioner; • when the creditors vote to terminate the restructuring; • when terminated by the court; or • when a restructuring plan that is approved by creditors takes effect (this might, by analogy with a deed of company arrangement (**DOCA**), require a document setting out the terms of the restructuring plan to be executed by the company and the restructuring practitioner).

	Topic	Proposed new or amended Corporations Act section	Submission
6	**When period under a restructuring plan starts and finishes**	453A(b) 453J 455B(2)	**Recommendation 6** • The Regulations should set out when the period that a company is under a restructuring plan starts and ends. • It should be clear that the period of "restructuring" ends when the "restructuring plan" period commences. The Exposure Draft does not set out when the period that a company is "under a restructuring plan" commences or when it ends. We assume it is intended that the Regulations will provide for this. We assume that the period that a company is "under a restructuring plan" will commence on the date that the restructuring plan is approved by creditors. Alternatively, by analogy with DOCAs, it might be the date that a document setting out the terms of the restructuring plan (so approved) is executed by the company and the restructuring practitioner. We assume that there will be a provision (similar to existing s 445C of the Corporations Act) specifying when the restructuring plan terminates, which would be on the earlier of: • when the restructuring plan terminates in accordance with its terms (either because it has been fully effectuated, or for some other reason); • the court orders the termination of the restructuring plan; or • the creditors pass a resolution terminating the restructuring plan. We assume it is intended that the company will not be under a "restructuring" and subject to a "restructuring plan" at the same time. In other words, we assume that the "restructuring" period is analogous to the period where a company is in administration, and the "restructuring plan" period is analogous to the period when a company is subject to a DOCA.

	Topic	Proposed new or amended Corporations Act section	Submission
7	**Consequences of termination of restructuring period**	N/A	**Recommendation 7** • There should be a provision clearly setting out the consequences of a "restructuring" terminating. • This provision should provide where creditors have approved a restructuring plan within the statutory timeframe, the company should become subject to that restructuring plan. • The provision should by default provide that where creditors have not approved a restructuring plan the company should enter liquidation. • The company should enter liquidation directly from the restructuring process (rather than returning to the control of its directors) in a manner similar to the direct entry into liquidation from administration provided for in existing s 446A of the Corporations Act. In most cases this would be the simplified liquidation process. • The company should only return to ordinary operation under the control of its directors if the company is solvent and with the consent of the restructuring practitioner or the approval of creditors. The Exposure Draft does not set out what happens upon the termination of a restructuring. It is critical that this is made clear. We believe this should be done in the Corporations Act rather than in the Regulations. In our view there should be a route by which a company can directly enter liquidation where a restructuring terminates. This should be the default consequence of the restructuring period terminating, except in circumstances where a restructuring plan has been approved and commences within the relevant prescribed timeframe. This direct route would be analogous to the ability of a company to enter liquidation directly from administration under Part 5.3A of the Corporations Act (see existing s 446A). We believe it would be appropriate for the company to enter liquidation (most likely under the simplified liquidation procedure) as the default option in such circumstances unless either:

Topic	Proposed new or amended Corporations Act section	Submission
		• the restructuring practitioner determines; or • the creditors vote, that the company should return to normal operation in the control of the directors. This should only be permissible in circumstances where the company is solvent. In some circumstances it might also be appropriate for a restructuring practitioner or the creditors to determine that the company enter administration, but we expect in practice it would be relatively rare that an administration would be useful to a small business that has already undergone a failed restructuring process. We take the view that it is appropriate that the company enter liquidation in these circumstances because a company is only likely to access the restructuring process in the first place if it is financially distressed (and the directors must form the view it is insolvent or likely to become so). In circumstances where the restructuring process has failed, it is likely that liquidation will be the most appropriate option in the majority of cases. Returning the company to normal operations in those circumstances would add an additional (and unnecessary) step involving the company or its creditors placing the company into liquidation. This would entail additional delay and cost. In addition, there would be uncertainty as to the operation of the company during any 'gap' period between the end of restructuring and commencement of liquidation (or any other another insolvency process).

	Topic	Proposed new or amended Corporations Act section	Submission
8	**Resolution by directors as to insolvency**	453B(1)(b)	**Recommendation 8** • Replace “reasonable grounds for suspecting” under new s 453B with “in the opinion of the directors voting for the resolution” (for consistency with existing s 436A of the Corporations Act). The Exposure Draft provides that a restructuring practitioner may be appointed under new s 453B by a resolution of directors if the directors voting for the resolution “**have reasonable grounds for suspecting**” that the company is insolvent, or is likely to become insolvent at some future time. This can be contrasted with the power of the board to appoint an administrator under existing s 436A, which instead applies if the board has resolved to the effect that “**in the opinion of the directors voting for the resolution**” the company is insolvent, or is likely to become insolvent at some future time. It is unclear whether this difference in language is intentional, and if so the reason for this. We note there is significant case law on the existing language used in s 436A. Therefore unless there are policy reasons for a change in approach (which should be addressed in the explanatory memorandum) we would recommend retaining the same language (used in s 436A) in the new s 453B.
9	**Notification of commencement of restructuring**	N/A	**Recommendation 9** • Introduce a provision requiring companies to file a public notice and notify creditors immediately upon the commencement of a restructuring process. The Exposure Draft does not currently make any provision for the notification of creditors or the broader public of the commencement of restructuring apart from the company under restructuring setting out in every public document and every negotiable instrument, the expression "restructuring practitioner appointed" as required by s 457B.

	Topic	Proposed new or amended Corporations Act section	Submission
			Given the significant impact of this process both on the company's creditors and other third parties dealing with the company it is important that there is some form of public notice (presumably with ASIC) immediately upon commencement of the restructuring, and also that the company is obliged to immediately notify its existing creditors of its entry into the restructuring process in addition to the giving of a declaration made by the restructuring practitioner upon being appointed, which is only required to be given to "as many of the company's creditors as reasonably practicable" under new s 453D of the Exposure Draft. This should be provided for in the Exposure Draft. We note in this regard paragraph [86] of the UNCITRAL Text which states: *"Giving notice of the commencement of insolvency proceedings is central to several key objectives of an insolvency regime. It ensures transparency of the proceedings and that all parties in interest are equally well informed and can timely challenge the commencement of the proceeding. For those reasons this [text] requires the notice of commencement of insolvency proceedings to be individually notified to all known parties of interest."*
10	**Eligibility criteria for restructuring process – liabilities of the company**	453C(1)(a)	**Recommendation 9** • Specify how liabilities will be calculated under new s 453C(1)(a). • Consider the appropriateness of any proposed liability cap having regard to the method of its calculation, the size of business that will be included or excluded by that cap and the liability

caps adopted for similar small business restructuring regimes in other comparable jurisdictions.

- Ensure the criteria and their calculation are simple and clear at the outset, so as to avoid any risk of proceedings subsequently being held to be invalid due to uncertainty or miscalculation of the company's liabilities.
- Review the liability cap once the legislation is in operation to consider whether it should be adjusted.

The new s 453C(1)(a) indicates that Regulations may establish a test for eligibility for the restructuring process based on the liabilities of the company.

Although the Regulations are yet to be released, we understand from the Joint Media Release issued by the Hon Josh Frydenburg MP and the Hon Michael Sukkar MP on 24 September 2020 that the Government is considering limiting the eligibility for the restructuring process to companies with liabilities not exceeding $1 million.

It is unclear how liabilities would be calculated for these purposes (eg whether they would include prospective, future, contingent or unliquidated amounts). This will need to be clarified in the Regulations. It is also important that such eligibility criteria are framed in a way that makes it clear from the outset of the process if the company does or does not qualify (to avoid the risk of invalid proceedings).

There are differing views as to the appropriate level of the liability cap for this regime. We understand that this liability cap has been selected on the basis that "[a]round 76 per cent of companies entering into external administration in 2018-19 had less than $1 million in liabilities" (according to the Government's fact sheet entitled "Insolvency reforms to support small business). Anecdotally, we believe that the percentage of companies entering into administration with less than $1 million in liabilities is likely to be far lower than 76%. We question whether this statistic is representative of actual business activity in Australia, although we are unable to confirm this without knowing how this statistic was calculated (for example, it may be influenced by the number of 'shell companies' which enter into administration). Importantly, we note that this statistic does not consider liabilities incurred by companies during and post the COVID-19 pandemic, and therefore the proportion of businesses that have incurred (or will incur) over $1 million in liabilities and have entered (or will enter) into external administration may be much higher.

If the Government chooses to retain the $1 million liability cap, consideration should be given to increasing it once the reforms have been implemented, there has been an opportunity to evaluate their performance and the business community has become broadly familiar with how they operate.

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We note that a cap based on a maximum of $1 million in liabilities would appear to be lower than the caps applicable to small business restructuring processes or small business liquidation proceedings in other jurisdictions.

For example:

- **United States**: to access the new Part V of Chapter 11 (for small businesses) a company must have aggregate, non-contingent liquidated secured and unsecured debts of less than **US$7.5 million** until 27 March 2021 (and **US$2,725,625** thereafter) under the Small Business Reorganization Act of 2019 as temporarily amended by the Coronavirus Aid, Relief, and Economic Security Act.
- **United Kingdom**: prior to being replaced this year by a stand-alone moratorium available to a broader range of companies, the moratorium for small businesses pursuing a company voluntary administration was available to companies who could satisfy two or more of the following criteria:

  (1) turnover of no more than **£10.2 million** for the financial year;

  (2) balance sheet assets no greater than **£5.1 million**; and

  (3) not more than 50 employees.
- **Singapore**: to be eligible for the new streamlined process recently proposed in the Insolvency, Restructuring and Dissolution (Amendment) Bill 2020 a company must have:

  (1) annual sales turnover for the relevant business year must not exceed **S$10 million**;

  (2) the applicant must not have more than 30 employees;

  (3) the applicant must not have more than 50 creditors; and

  (4) the liabilities of the applicant company (including contingent and prospective liabilities) must not exceed **S$2 million**.

Consideration should therefore be given to whether a higher threshold would be appropriate either now or at some point in the future to ensure that the restructuring process has utility beyond very small companies.

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11	**Eligibility criteria for restructuring process – common directors**	453C(1)(b)	**Recommendation 11** • Delete the eligibility requirement under s 453C(1)(b). New s 453C(1)(b) of the Exposure Draft provides that the restructuring procedure under proposed Part 5.3B cannot be used by a company if a director of the company (or someone who has been a director of the company in the previous 12 months) has been a director of another company that has been under restructuring or been the subject of a simplified liquidation process within a period prescribed by the Regulations unless exempt under regulations made for the purposes of s 453C(2). Paragraph (2)(b) provides that the Regulations may prescribe the circumstances in which the directors of companies are exempt from the requirement in paragraph (1)(b). Consideration should be given to whether this eligibility criteria is arbitrary, and could lead to companies needlessly being excluded from the restructuring regime. In particular: • where companies are largely unrelated (for example, they may only have a single director in common, and only for a brief period in time) it is unclear why the first company accessing the restructuring process should preclude the second company from accessing the restructuring process; • where the companies are related (for example, part of the same corporate group) more than one entity may need to access the restructuring process, but it is unclear whether this is permitted (and if it is permitted whether it is necessary for the companies to enter into the process at exactly the same time). Again, it is unclear why this should preclude access. Consideration should be given as to the policy basis for this criteria, and whether it is necessary or can be addressed in another manner. Additional uncertainty is created by the fact that a restructuring practitioner or current director(s) may not always know if a previous or current director(s) fail the eligibility test. It is unclear if and how this information will be made available, such as through an ASIC company search. We therefore recommend that the eligibility requirement under s 453C(1)(b) is deleted.

	Topic	Proposed new or amended Corporations Act section	Submission
12	**Functions of restructuring practitioner**	s 453E(1)	**Recommendation 12** • Broaden the scope of s 453E(1) to recognise the deliberative aspects of the restructuring practitioner's role. The new s 453E(1) provides that the function of the restructuring practitioner will be to provide advice to the company on matters relating to restructuring, assist the company to prepare a restructuring plan, make a declaration in relation to the same in accordance with the Regulations, and any other functions provided under the Act. This suggests that the restructuring practitioner will have a mainly advisory role, and that decisions will largely be made by the company. However, we note that other provisions suggest that the restructuring practitioner will have a more deliberative role despite the company being a debtor in possession. For example: • the restructuring practitioner is taken to be acting as the company's agent (new s 453H); • the restructuring practitioner may decide to terminate the restructuring process (new s 453J); • the restructuring practitioner may consent to the company entering into transactions outside the ordinary course of business (new s 453L(2)); • the restructuring practitioner may consent to transfers of or adjustments to members' shares (new s 453N); • the restructuring practitioner may consent to security enforcement or exercise of third party property rights (new s 453Q); • the restructuring practitioner may consent to legal proceedings against the company (new s 453R); • the restructuring practitioner may consent to enforcement of ipso facto rights (new s 454P(7)). These powers appear to go beyond the advisory role described in s 453E. We expect that a court may have regard to s 453E as an interpretive aid when considering the powers and duties of the restructuring practitioner under the legislation more generally (similarly to

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			how a court may rely on new s 452A which explains the object of Part 5.3B). We therefore believe it is important that the functions set out in this section accurately reflect the nature of the role. We recommend broadening the language of s 453E to recognise the deliberative aspects of the restructuring practitioner's role during the restructuring.
13	**Duties of restructuring practitioner**	N/A	**Recommendation 13** • Insert a general provision indicating the duties of the restructuring practitioner. • For example this could require the restructuring practitioner to exercise its powers or discretions under the legislation having regard to the interests of creditors. The Exposure Draft does not contain any general provisions with regard to what (if any) duties are owed by the restructuring practitioner when carrying out its functions. The Exposure Draft does provide that the restructuring practitioner becomes an officer of the company under s 9 (as amended) and therefore, all statutory provisions concerning the duties of an officer under the Corporations Act will apply including the duty to act in the best interests of the company. We note that some, but not all, of the new sections require the restructuring practitioner to consider the interests of creditors when making particular decisions, such as new ss 453J(1)(a) and 453L(5). We recommend that consideration is given to including a general provision indicating the duties of the restructuring practitioner. For example, this might require the restructuring practitioner to exercise its powers or discretions under the legislation having regard to the interests of creditors.

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14	**Requirement for restructuring practitioner to hold beliefs on "reasonable grounds"**	453J(1)(a) 453L(5)	**Recommendation 14** • Delete requirement that the restructuring practitioner must hold beliefs on "reasonable grounds" under new ss 453J(1)(a) and 453L(5). Certain provisions of the Exposure Draft require the restructuring practitioner to hold beliefs on "reasonable grounds". This requirement differs from the requirement in the corresponding administration procedures upon which those provisions were based. We recommend that the requirement that the restructuring practitioner hold beliefs on "reasonable grounds" be deleted to ensure consistency in approach and interpretation with the corresponding provisions applicable to administrators.
15	**Appointment of restructuring practitioner as liquidator – preventing conflicts of interest**	N/A	**Recommendation 15** • Restrict person(s) appointed as restructuring practitioner to a company from subsequently being appointed as liquidator of the same company in order to prevent conflicts of interest. • Restrict any other person who is a partner, director or employee of the same firm as the restructuring practitioner from subsequently being appointed as liquidator of the company. The Exposure Draft does not prevent a person who has been appointed as a restructuring practitioner to a company subsequently being appointed as its liquidator. We note that a conflict of interest (or the appearance of a conflict of interest) may arise on the basis that the restructuring practitioner may be influenced by the prospect of earning more fees as a liquidator if the company was to enter liquidation (than if the company was to implement a restructuring plan). We therefore recommend that such a restriction be introduced. Such a restriction should apply to restrict:

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			• the person actually appointed as restructuring practitioner of the company; and • any other person who is a partner, director or employee of the same firm as the restructuring practitioner, from undertaking any liquidation of the company that immediately follows the restructuring or restructuring plan. We note this may require a Government mandated default liquidator to take the appointment in circumstances where the creditors or the restructuring practitioner do not determine the liquidator to be appointed at the time that the restructuring is terminated.
16	**Right to inspect books held by other persons**	453G	**Recommendation 16** • Introduce consequences under new s 453G for persons who refuse a restructuring practitioner access to the books of a company, such as through the notice procedure prescribed by existing s 438C of the Corporations Act. We note that the new s 453G empowers a restructuring practitioner to inspect and make copies of the company's books at any reasonable time. Unlike the existing s 438C of the Corporations Act, there appears to be no consequences for refusing access to the books of a company. We recommend the use of a notice procedure similar to that provided under the existing s 438C in order to address this concern.

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17	**Ability to incur debts during restructuring period**	453L	**Recommendation 17** Restrict a company under restructuring from: • incurring debt unless it is in the ordinary course of business, with the consent of the restructuring practitioner or under an order of the court; and • obtaining or incurring further credit (in an amount exceeding an appropriate threshold) without notifying the relevant creditor that the company is under restructuring. The Exposure Draft does not expressly provide for the extent to which a company that is subject to a restructuring process may incur further debt. This needs to be made clear. The new s 453L provides that a company under restructuring is prevented from entering into a transaction or dealing affecting the property of the company during the restructuring unless it is in the ordinary course of business, with the consent of the restructuring practitioner or under an order of the court. However, this prohibition does not restrict the company from incurring debt during the restructuring period. We therefore recommend the inclusion of an additional provision that prevents the company from incurring debt during the restructuring period unless it is in the ordinary course of business, with the consent of the restructuring practitioner or under an order of the court. We also recommend a requirement that a company cannot obtain or incur further credit (in an amount exceeding an appropriate threshold) without notifying the relevant creditor that the company is under restructuring. It is important that any potential creditors are made aware of the restructuring and are able to determine whether to extend any further credit to the company on an informed basis given the increased risk involved. We note that such a requirement is included in s A25 of the *Insolvency Act 1986* (UK) in respect of the UK's new moratorium regime (which has many similarities to the proposed restructuring regime).

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18	**Offence relating to transactions and dealings affecting property during restructuring period**	453L	**Recommendation 18** • Confine criminal liability for directors under new s 453L to cases where the director acted dishonestly or intentionally caused a serious breach of s 453L. The Exposure Draft currently provides that a failure to comply with s 453L(1) is an offence. New Schedule 3 provides that a contravention of this section could lead to 6 months imprisonment. In our view, this would be inappropriate for a debtor in possession process as it may encourage an excessively cautious approach by directors who may delegate decision making to restructuring practitioners in order to avoid criminal liability. We believe this is not the intent of the reforms. We also note that "in the ordinary course of a company's business" is a concept that could admit a broad range of interpretations. In these circumstances, it may be more appropriate to confine criminal liability for directors to cases where the director acted dishonestly or intentionally caused a serious breach of s 453L. Other types of breaches could be dealt with by the voidability provisions and any other applicable civil remedies.
19	**Payment of pre-restructuring debts during restructuring period**	453L	**Recommendation 19** • Introduce a provision prohibiting companies from making payment on any debt (over a de-minimis amount) incurred prior to the commencement of restructuring without the consent of the restructuring practitioner or by order of the court. • An exception should be provided that permits a company under restructuring to pay any employee entitlements that are due and payable (regardless of when they were incurred). The Exposure Draft does not currently specify whether the company under restructuring is entitled to make any payments of debts incurred prior to the commencement of the restructuring (and if so in what circumstances). This is a very important matter that needs to be carefully considered. The normal principle would be that once a formal restructuring or insolvency process has been commenced, all (non-priority) debts

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		incurred prior to the process should only be paid as part of a plan or insolvency distribution on a pari-passu basis. Any payment of 'pre-petition' debts would disrupt this basic principle and would generally be considered an unfair advantage by other creditors. This principle is not specifically addressed in connection with voluntary administration as the process is run by an administrator that understands that generally pre-administration debts should not be paid unless it is necessary to do so for the continuing operation of the business. A similar principle should apply in a restructuring. The Exposure Draft should specifically provide that the company cannot make payment on any debts incurred prior to the commencement of the restructuring (perhaps over a de-minimis amount) without the consent of the restructuring practitioner or by order of the court. The restructuring practitioner can then make an independent assessment as to whether payment of the pre-restructuring creditor is necessary for the ongoing operation or viability of the business. We note that introduction of such a provision would also be consistent with the approach adopted in s A28 of the *Insolvency Act 1986* (UK) in connection with payment of debts under the new moratorium regime in the United Kingdom (which shares some similarities with the proposed restructuring regime). There should be an exception to this restriction to allow a company under restructuring to pay any employee entitlements that are due and payable (regardless of when they were incurred) given these liabilities are given priority over unsecured debts in a liquidation (and given we understand the Government may requirement payment of such debts to be a pre-requisite to proposing a restructuring plan to the creditors).

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20	**Grant of security during restructuring period**	453L	**Recommendation 20** • Introduce a provision prohibiting companies under restructuring from granting security without the consent of the restructuring practitioner or by order of the court. • An exception should be provided that applies to the granting of ROT/PMSI type security in respect of new goods supplied and new credit incurred post restructuring, in the ordinary course of business. The Exposure Draft does not currently specify whether a company may grant any security over its assets during the restructuring period (although it might be implied that this would normally not be permitted as, for most businesses, granting security would not be done in the ordinary course of business). It would be prudent and appropriate for the Exposure Draft to introduce a specific provision prohibiting a company from granting security without the consent of the restructuring practitioner or by order of the court. We note that introduction of such a provision would also be consistent with the approach adopted in s A26 of the *Insolvency Act 1986* (UK) in connection with grant of security under the new moratorium regime in the United Kingdom. However, there should be an exception to permit ROT/PMSI type security in respect of new goods supplied and new credit incurred post restructuring, in the ordinary course of business.

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21	**Dealing with secured assets during restructuring period**	N/A	**Recommendation 21** • Introduce provisions addressing the extent to which a company is entitled to deal with assets that are subject to security during a restructuring, and what protections a secured party will have if such dealings occur, similar to existing ss 442B and 442C of the Corporations Act. The Exposure Draft does not specifically address the extent to which a company is entitled to deal with assets that are subject to security during a restructuring, or what protections a secured party has if such dealings occur. These issues are addressed in respect of administration under existing ss 442B (Dealing with property subject to circulating security interests) and 442C (When administrator may dispose of encumbered property). However, the Exposure Draft does not contain comparable provisions applicable to the restructuring process. Provisions that specifically provide for the treatment of secured assets in a restructuring should be included in a manner broadly consistent with existing ss 442B and 442C. These existing provisions provide a reasonable balance between protecting the interests of secured creditors and debtors, and is a regime that creditors in the Australian market are familiar with. It would therefore provide an appropriate basis for similar provisions to be introduced in respect of the restructuring process.
22	**Effect of restructuring on company's members**	453N	**Recommendation 22** • Replace requirement in new s 453N(2) that a transfer must be "in the best interest of the company's creditors as a whole" with a requirement that "there is no prejudice to any creditor". The requirement in new s 453N(2) that the "transfer is in the best interest of the company's creditors as a whole" is too restrictive. This requirement would make it difficult in practice for consent to be given to a transfer since, in most cases, it would have no effect (either good or bad) on creditors. We consider that this should be replaced with that "there is no material prejudice to any creditor".

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23	**Moratorium – stay on voluntary winding up**	453P	**Recommendation 23** • Prohibit shareholders from being able to initiate a voluntary liquidation of the company without the consent of the directors and the restructuring practitioner while the company is under restructuring by amending new s 453P. • Also consider prohibiting shareholders from changing the directors of a company under restructuring except with the consent of the restructuring practitioner. The Exposure Draft appears to introduce new moratorium provisions for a restructuring that largely replicate the existing moratorium provisions applicable in an administration. However the new s 453P does not include a restriction on the commencement of a voluntary winding up while the company is under restructuring (in contrast to the existing s 440A(1) applicable in an administration). There should be a restriction on the company (i.e. shareholders who commence a voluntary liquidation through a shareholders' resolution) commencing a voluntary liquidation while a company is under restructuring. Such a liquidation process could be initiated by shareholders in circumstances that disrupt a viable restructuring being undertaken by the company (i.e. its directors) with the assistance of a restructuring practitioner. This could be detrimental to creditors of the company, and might possibly be done as a means of exerting leverage on creditors. Therefore any voluntary liquidation process should only be commenced during the restructuring period with the consent of the directors and the restructuring practitioner. We note that a similar restriction on shareholders initiating voluntary liquidations applies under the new moratorium procedure in the UK (see s A20 of the *Insolvency Act 1986* (UK)). Similarly, consideration should be given to whether there should be a prohibition on shareholders changing directors of a company while it is subject to a restructuring without the consent of the restructuring practitioner.

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24	**Ipso facto stay**	454P – 454T	**Recommendation 24** • See Recommendations 25 to 27. The Exposure Draft introduces ipso facto stay provisions for a restructuring (new ss 454P – 454T) which are largely the same as the existing ipso facto stay provisions applicable to an administration (under ss 451E – 451H). This consistency is appropriate, although certain specific issues needs to be addressed, as set out in the following sections.
25	**Ipso facto stay – exceptions**	454P(5)(b) and (6)	**Recommendation 25** • Apply existing exceptions to the ipso facto stay in respect of schemes of arrangement, receivership and administration to the ipso facto stay under new s 454P. New ss 454P(5)(b) and 454P(6) provide that certain rights and contracts can be excluded from the operation of the ipso facto stay by regulations or declarations. The *Corporations (Stay on Enforcing Certain Rights) Declaration 2018* (Cth) and regulations 5.1.01, 5.2.50 and 5.3A.50 of the *Corporations Regulations 2001* (Cth) provide for exceptions to the ipso facto stay in respect of schemes of arrangement, receivership and administration. As a matter of consistency the same exceptions should apply to the ipso facto stay under s 454P. These existing regulations and declarations should be amended so that the exceptions under those regulations and declarations also apply to the ipso facto stay under the new s 454P.

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26	**Ipso facto stay – restructuring plan**	454P	**Recommendation 26** • Amend new s 454P so that it also applies to a company proposing, coming under or being subject to a restructuring plan. • Consistently, amend existing s 451E so that it also applies to a company proposing, coming under or being subject to a DOCA. The ipso facto provisions in the new s 454P appear to apply to a right that arises by reason that the company "has come or is under restructuring" (sub-s (1)). However, the new s 454P does not appear to stay any right arising by reason of the company proposing, coming under or being subject to a restructuring plan. This appears to be a lacuna, and we would recommend that this is addressed so that such matters are also subject to an ipso facto stay. Corresponding adjustments would also need to be made to the stay period. We note that a similar lacuna currently applies to the proposal of or entry into DOCAs under existing s 451E, and this gap should also be addressed.
27	**Ipso facto stay – grandfathering of contracts pre-1 July 2018**	454P	**Recommendation 27** • Introduce grandfathering exceptions for the ipso facto stay provisions relating to restructuring consistent with those applying to the existing ipso facto regime for schemes, receivership and administration. • This should be achieved by including a section in the Exposure Draft which states that the ipso facto stay related provisions introduced under the Exposure Draft apply in relation to

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rights arising under, or self-executing provisions of, contracts, agreements or arrangements entered into on or after 1 July 2018

- Consistently with the other grandfathering exceptions is addressed in our Submission 25 above.

We note the existing ipso facto stay regime applicable to schemes of arrangement, receiverships and administrations is subject to a "grandfathering" exception under s 17 of the *Treasury Laws Amendment (2017 Enterprise Incentives No.2) Act 2017* (Cth) (**TLA Act**) and regulation 3 of the *Corporations Amendment (Stay on Enforcing Certain Rights) Regulations 2018* (Cth) (**CA Regs**). The effect of the grandfathering provisions is that arrangements entered into prior to:

- the commencement of the ipso facto regime on 1 July 2018, and
- 1 July 2023 which novate or assign rights under an arrangement entered into before 1 July 2018,

are excluded from the ipso facto stay regime.

In particular, s 17 of the TLA Act provided that: *"The amendments made by this Part apply in relation to rights arising under, or self-executing provisions of, contracts, agreements or arrangements entered into at or after the commencement of this Part."*

It does not appear that the Exposure Draft contains any equivalent to s 17 of the TLA Act. For consistency, we recommend that a section is included in the Exposure Draft providing that the ipso facto stay related provisions apply in relation to rights arising under, or self-executing provisions of, contracts, agreements or arrangements entered into on or after 1 July 2018.

We also recommend that the grandfathering provisions in the CA Regs are extended to the ipso facto provisions applicable to the restructuring regime, which could be achieved by adopting the recommendations made in Submission 25 above.

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28	**Consequences of termination of restructuring plan**	455B	**Recommendation 28** • The comments made in respect of restructurings in Submission 7 also apply in respect of restructuring plans. • Specify in the Regulations that a restructuring plan will remain effective even if eligibility issues in respect of entry into the restructuring process are later discovered. The comments made in respect of restructurings in Submission 7 also apply in respect of restructuring plans. In these circumstances it should also be possible for the company to directly enter liquidation, subject to any determination to the contrary of the restructuring practitioner or creditors. Separately, the Regulations should make it clear that a restructuring plan will need to remain effective even if eligibility issues in respect of entry into the restructuring process were later discovered.
29	**The restructuring plan**	455B	**Recommendation 29** • The key principles regarding the restructuring plan should be set out in the Corporations Act rather than in the Regulations. • Generally have regard to the UNCITRAL Text when formulating the detailed requirements of the restructuring plan. We understand that all of the substantive provisions relating to the restructuring plan are to be provided for in Regulations that have not yet been released. We therefore cannot comment on the new restructuring plan at this stage. These provisions will be critical to the success of the reform.

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			The key principles of the operation of the restructuring plan should be set out in the Corporations Act rather than in the Regulations. We also recommend that Government has regard to the recommendations in the UNCITRAL Text when formulating the detailed requirements of the restructuring plan.
30	**The restructuring plan – giving priority to eligible employee creditors**	455B	**Recommendation 30** • The Regulations should include a requirement, similar to existing s 444DA of the Corporations Act, that requires a restructuring plan to give priority to eligible employee creditors at least equal to what they would receive in a liquidation under ss 556, 560 and 561. Existing s 444DA of the Corporations Act (Giving priority to eligible employee creditors) requires a DOCA to include a provision that any eligible employee creditors will be entitled to a priority at least equal to what they would have been entitled to in a winding up of the company under ss 556, 560 and 561 (subject to prescribed exceptions). However, the Exposure Draft does not contain comparable provisions applicable to a restructuring plan. We recommend the inclusion of an employee entitlements provision similar to existing s 444DA of the Corporations Act. Any other payments that would have priority in the liquidation (such as in our recommendation debts incurred during the restructuring in the circumstances outlined in Submission 40 below) should also be required to have priority under the restructuring plan.

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31	**Standardised restructuring plan documentation**	455B	**Recommendation 31** • Insert pro forma restructuring plans in a schedule to the Regulations. • Insert other standard forms and templates in connection with the restructuring process and restructuring plan (e.g. standard forms of notices to creditors, disclosure forms, checklists, etc.). We recommend the inclusion of one or more pro forma restructuring plans in a schedule to the Regulations. This will reduce costs and provide some consistency in the terms of the plans being proposed. It will also simplify the process and reduce costs for all stakeholders. The language and drafting of such standardised documents should be clear, relatively simple and user friendly, in order to facilitate use by the general public and small businesses. Where possible or appropriate, other standard forms and templates should be provided in connection with the restructuring process and restructuring plan to further simply and standardise the process. This could include standard forms of notices to creditors, disclosure forms, checklists and the like. In this regard we note recommendation 6 of the UNCITRAL Text, which states: *"The insolvency law providing for a simplified insolvency regime should specify measures to make assistance and support with the use of a simplified insolvency regime readily available and easily accessible. Such measures may include services of an independent professional; templates, schedules and standard forms; and an enabling framework for the use of electronic means where information and communication technology of the State so permits and in accordance with other applicable law of that State."* We also note the comments made at paragraph [49] of the UNCITRAL Text in this regard.

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32	**Effect of the restructuring plan on shareholders and third parties**	455B	**Recommendation 32** • Consideration should be given to how guarantees granted by directors, owners or family members in respect of debts of the company will be addressed under the restructuring plan, and whether the plan should be able to modify or discharge these liabilities. • Regard should be had to the UNCITRAL Text in this respect. • Consideration should be given to whether the statute needs to expressly contemplate that the Regulations can provide for third party releases under a restructuring plan. It is unclear from the draft legislation whether it is intended that a restructuring plan will be able to modify or discharge liabilities owing by third parties. Under existing Australian law, third party releases cannot be achieved under a DOCA, but can be achieved under a creditors' scheme of arrangement. This will be important to consider in respect of guarantees granted by directors or owners of a small business (which is a common occurrence and which are frequently secured by real property mortgages granted by directors or owners over their residential homes). In this regard we note recommendation 74 in the UNCITRAL Text: *"A simplified insolvency regime should address, including through procedural consolidation or coordination of linked proceedings, the treatment of personal guarantees provided for business needs of the MSE debtor by individual entrepreneurs, owners of limited liability MSE's or their family members."* We note also the further comments at paragraphs [156]–[160] of the UNCITRAL Text. It may be that the issue of third party releases is intended to be addressed in the Regulations. If so, consideration should be given as to whether the enabling language in the statute is broad enough to allow the plan to address the debts of third parties as well as debts of the company itself.

	Topic	Proposed new or amended Corporations Act section	Submission
33	**Proposing a restructuring plan – payment of employee entitlements**	455B	**Recommendation 33** • The Regulations should **not** require that all employee entitlements that are due and payable must be paid before a company can put a restructuring plan to its creditors. • Instead, the Regulations should require that where the company has not paid all employee entitlements that are due and payable at that time, such payments must be made under the restructuring plan ahead of any payments to normal unsecured creditors. The pre-requisites for proposing a restructuring plan are not set out in the Exposure Draft, but new s 455B instead contemplates that such requirements will be addressed in the Regulations. However, paragraphs [1.94]–[1.95] of the draft Explanatory Materials indicate that the Regulations could require the company to pay any employee entitlements which are due and payable before it can put a restructuring plan to its creditors. From discussion with our members we are concerned that in many cases a small business will not have met all its employee entitlements, and it may be difficult to do so prior to proposing a restructuring plan. Indeed, in some circumstances, some compromise of historic employee entitlements may be needed in order for a restructuring plan to be viable. Clearly it is preferable that employee entitlements be up to date, and paid in full. However in circumstances where the alternative is a liquidation of the company, where employees may be paid nothing or very little (and lose their jobs), it may be preferable for employees to compromise some of their entitlements to ensure some payments and ongoing employment. We recommend that further consideration be given to whether all employee entitlements must be paid in full before a restructuring plan is proposed. We suggest the removal of this requirement. Instead, where payment has not been made of all employee entitlements that are due and payable, these payments should be required to be made under the restructuring plan ahead of any payments to normal unsecured creditors. There should also be a requirement that the restructuring practitioner is satisfied that the outcome for each employee under the restructuring plan is at least as good as the outcome for that employee in a liquidation of the company – see Submission 30.

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34	**Voting on the plan**	455B	**Recommendation 34** • This is an important aspect that will need to be addressed. We repeat Recommendation 29.
35	**Challenging the plan**	455B	**Recommendation 35** • This is an important aspect that will need to be addressed. We repeat Recommendation 29.
36	**Registered liquidator / who can be a restructuring practitioner?**	456B	**Recommendation 36** • Extend the class of people qualified to undertake the restructuring practitioner role beyond registered liquidators. However, only registered liquidators should undertake the new simplified liquidation process if that is the outcome of the restructuring plan. • Introduce the eligibility criteria set out in this submission as a pre-requisite to becoming a restructuring practitioner. • Monitoring the admission and administering this new restructuring practitioner class should be overseen by either: (i) ASIC, (ii) selected appropriate professional associations, and/or (iii) the establishment of a supervisory board, as further described in this submission. New s 456B provides that a restructuring practitioner must be a registered liquidator. Treasury previously announced that a new classification of registered liquidator will be introduced whose practice will be limited to the new simplified restructuring process only. The Exposure Draft does not provide further detail on this new classification. For the avoidance of doubt (and perhaps somewhat confusingly), this new class of liquidators, being restructuring practitioners, should not be permitted to act as liquidators (either in a normal liquidation or simplified liquidation process) given the expertise required for liquidation. We understand that one of the reasons behind s 456B could

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		be to subject a restructuring practitioner to the same professional obligations as a registered liquidator given concerns over phoenix activity. The risk with taking this approach is that it will likely lead to confusion. A restructuring practitioner is called a “practitioner” for good reason – they oversee a restructuring process with a view to saving a company. Liquidators, on the other hand, liquidate a company and bring an end to its life. While there has been commentary around an amorphous group called pre-insolvency advisors who promote phoenixing, no evidence has been put forward as to precisely who these people are. Tellingly, the only way to effect a phoenix transaction is via liquidation and the engagement of a registered liquidator. Due to Australia's economic success over generations there is a lack of an SME restructuring profession that is readily identifiable. It needs to be grown. In absence of that and for this reason we believe the best means of expanding the number of qualified persons who are able to perform all steps associated with the small business restructure other than an ordinary or simplified liquidation is to look to the criteria set out below. In short, the best people to help restructure a small business will be local senior accountants and possibly lawyers, particularly in suburban and regional Australia. For businesses in the agricultural sector (including farmers),involvement of rural debt counsellors may also be appropriate. Using the analysis contained on Appendix 1 the TMA is therefore supportive of extending the class of people qualified to undertake the restructuring practitioner role beyond current registered liquidators. We consider that facilitating a restructuring and assisting a company formulate a restructuring plan is something that could be carried out by a broader class of appropriately qualified professionals, however given the roles (i.e. acting as fiduciary and handling third party funds) and skills required, it is important that the requisite independence, experience and regulation remains. This should be administered by ASIC under the new classification. In addition, given the size of the businesses involved, and the potential for large numbers of small businesses to seek to avail themselves of this process, it will be important that small businesses are readily able to access professional assistance in this regard. The TMA notes the following criteria which broadly reflect the output from discussion within the restructuring community, accounting bodies and advocacy groups regarding a possible framework for appropriate qualifications to be a restructuring practitioner:

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		• being a member of an appropriate professional association (for example, CAANZ, CPA, IPA, ABRT, TMA, ICB) with a code of ethics and suitable accreditation process to undertake the restructuring practitioner role; • having adequate professional indemnity insurance or a practice certificate; • being a 'fit and proper person' (ie the person has never been convicted of a financial crime, been an undisclosed bankrupt, etc.); • agreement to participate in a disciplinary process and/or alternate dispute resolution at their cost (eg through ASBFEO or the professional association referred to above); • at least 5 years in professional practice and have satisfied minimum training requirements; and • independence from the debtor company (which we recommend should be a legislative requirement). It is important that these criteria are satisfied. We consider three options for admitting and administering the new class of insolvency adviser as follows: • ASIC to administer licensing and ongoing compliance in respect of the new classification; • selected appropriate professional associations (for example, CAANZ, CPA, IPA, TMA, ICB) undertake the accreditation and oversight of members seeking to hold the restructuring practitioner role; and • the establishment of a supervisory board with representatives from the respective bodies (e.g. the Law Society of each state, CAANZ, TMA, ARITA and CPA) who will receive and adjudicate upon applications in a prescribed form on a regular basis. We consider that the definition of this new class of restructuring practitioner/registered liquidator should be included in Schedule 2 and the associated rules. The rules should 'release' this class of persons to undertake the restructuring practitioner role and should not require further vetting by any other body. However, we note that only registered liquidators (as that concept is currently formulated) should undertake the new simplified liquidation process if that is the outcome of the restructuring plan. We

	Topic	Proposed new or amended Corporations Act section	Submission
			consider that a liquidation process, whether or not simplified, requires specialist skills that only registered liquidators have. In making this submission our methodology was to assess the various elements of the Small Business Restructuring Professional role (see attached matrix style format at Appendix 1 to these submissions) and to compare and contrast the skill sets across the universe of advisers that could fulfil the role. We considered the competency of likely potential participants against each element of the role per the legislation. We believe this is a robust and unbiased approach to assessing the appropriate participants to fulfil the role that does not seek to favour any one professional group but seeks to focus on the intent of the proposed reform and the size of the potential problem it is seeking to solve.
37	**Appointment of 2 or more restructuring practitioners**	456J 456K	**Recommendation 37** • Remove the ability of a company to appoint two or more restructuring practitioners. We query why the Exposure Draft explicitly provides for the appointment of two or more restructuring practitioners to be appointed. We note that the restructuring process only applies to very small businesses, and the process is intended to be very brief. The role of the restructuring practitioner is also intended to be relatively limited, compared to an administrator, given this is a debtor in possession process. In such circumstances it is difficult to see why multiple restructuring practitioners would need to be appointed, and doing so would likely increase costs. We therefore recommend that all references to the ability to appoint two or more restructuring practitioners be removed from the legislation.

	Topic	Proposed new or amended Corporations Act section	Submission
38	**Eligibility criteria for simplified liquidation process – common directors**	500AA(1)(e)	**Recommendation 38** • Delete or amend new s 500AA(1)(e) in order to avoid unintended and arbitrary consequences. • Consider whether the policy basis for this criteria can be addressed in another manner. Similarly to the new s 453C(1)(b) (as discussed in Submission 9 above), the new s 500AA(1)(e) excludes a company if a director of the company (or someone who has been a director of the company in the previous 12 months) has been a director of another company that has been under restructuring or been the subject of a simplified liquidation process within the relevant period. The same comments made in Submission 9 above apply to this requirement.
39	**Eligibility criteria for simplified liquidation process – liabilities of the company**	500AA(1)(d)	**Recommendation 39** • We repeat the comments in made in Submission 10 in this context also. Similarly to the new s 453C(1)(a) (as discussed in Submission 10 above), the new s 500AA(1)(d) indicates that regulations may establish a test for eligibility for the simplified liquidation process based on the liabilities of the company. The same comments made in Submission 10 above apply to this requirement.

	Topic	Proposed new or amended Corporations Act section	Submission
40	**Treatment of debts incurred in restructuring in a subsequent liquidation**	513A 513B 513CA 553 556(1)(c)	**Recommendation 40** • Insert a new s 556(1)(ca) providing priority treatment in any subsequent liquidation to any debt that is incurred in the ordinary course of business, with the consent of the restructuring practitioner, or by the order of the court during the restructuring period. • Consistent with the current drafting of the Exposure Draft, debts incurred during the restructuring period should not be admissible to proof in the liquidation under s 553. The treatment of debt incurred during a restructuring (prior to the company becoming subject to a restructuring plan) is currently somewhat unclear. The treatment of debt incurred during a restructuring (prior to the company becoming subject to a restructuring plan) is currently somewhat unclear. It appears that such debts would **not** be admissible to proof against the company in a subsequent liquidation due to the various proposed amendments to ss 513A and 513B, and the introduction of new s 513CA. We note that the position appears to be different in respect of debts incurred by the company once it is subject to a restructuring plan by virtue of the amendments to s 553. Such debts incurred in the restructuring would also **not** appear to be priority claims in a liquidation either. This position differs from the position in an administration, where the administrator is personally liable for most debts incurred during the administration, and the administrator is entitled to be indemnified, and has a lien, for such liabilities under ss 443D, 443E and 443F. The right of indemnification is treated as a priority claim in the liquidation under s 556(1)(c). It appears to us that the restructuring practitioner is not personally liable for any of the debts incurred by the company during a restructuring. Accordingly, any indemnification right granted to the restructuring practitioner under the Regulations, and the priority given to that indemnification right in a liquidation under the amended s 556(1)(c) will not provide any benefit to creditors who incurred debts during the restructuring. It would therefore appear that debts incurred during a restructuring may not be eligible for payment at all during a subsequent liquidation. If this is the case, it is presumably unintended.

	Topic	Proposed new or amended Corporations Act section	Submission
			The TMA is of the view that any debt that is incurred in the ordinary course of business, with the consent of the restructuring practitioner, or by the order of the court during a restructuring should be afforded priority in any subsequent liquidation. This could be done by inserting a new s 556(1)(ca) providing for this priority treatment. Assuming this is done, we would also consider it appropriate that such debts continue **not** to be provable in the liquidation (consistently with debts incurred during administration). From a commercial perspective, we consider this priority treatment in a liquidation to be a bare minimum requirement for any creditor to be willing to extend any further credit to a company once it is subject to a restructuring process. (For many creditors this will still be insufficient protection and they will require payment on delivery or require other protection.) This would also be consistent with normal, well accepted insolvency principles which provide that any 'post-petition' credit should have priority over 'pre-petition' creditors.
41	**Insolvent trading liability**	455A(2) 588GAAB	**Recommendation 41** • Delete new s 455A(2). • Remove the evidential burden on directors prescribed by new s 588GAAB. A company that is subject to a restructuring or a restructuring plan is still under the control of its directors (see for example new s 453K(1)). Therefore the risk of insolvent trading liability under existing s 588G will continue to accrue to directors during these periods, subject to any specific exceptions or defences available to them. This risk is compounded by the fact that the directors will have resolved at the outset of the restructuring that the company is insolvent or likely to become so (under new s 453B) and the company will be taken to be insolvent when it proposes a restructuring plan (under new s 455A(2)). It is unclear why it is necessary for the company to be deemed insolvent in the circumstances where the company proposes a plan, and this could act as a deterrent to using this process. We therefore recommend deleting this new s 455A(2).

	Topic	Proposed new or amended Corporations Act section	Submission
			We note that new s 588GAAB appears intended to provide directors with some protection against liability for debts incurred during the restructuring of the company. The protection under the new s 588GAAB only extends to debts incurred in the ordinary course of the company's business, with the consent of the restructuring practitioner or by order of the court. The directors bear an evidential burden with respect to these matters. We query whether it is necessary or appropriate to impose an evidential burden on directors in these circumstances. There is no evidential burden for the current insolvent trading safe harbour applicable to debts incurred in the ordinary course of business. These matters should be matters of fact to be determined in the normal manner. It would also appear that including such an evidential burden would encourage significant documentation of trading decisions which may not be practical for a small business in the ordinary course of business.
42	**Voidable transactions**	588FE(2C) 588FE(2D)	**Recommendation 42** • We repeat the recommendations, made in Submission 7 and Submission 28 above, that a company be able to transition directly from being under restructuring, or under a restructuring plan, respectively, to liquidation. • This is to ensure there is no 'gap' such that new ss 588FE(2C) and 588FE(2D) can operate as intended. The Exposure Draft includes various amendments to the definition of relation back day (Corporations Act s 91) to include a "s 513CA day" for a company subject to restructuring or a restructuring plan immediately before winding up. It also makes various amendments to the voidable transactions provisions. We understand that the intent of these amendments is to have the voidable transactions regime applicable to a restructuring process operate in a similar way to the current regime applicable to an administration process, which we consider appropriate. However, we note a possible technical issue with respect to new ss 588FE(2C) and 588FE(2D). These voidable transactions provisions operate where the winding up "immediately" follows the restructuring or the restructuring plan. However, it currently appears that (unlike in an administration

	Topic	Proposed new or amended Corporations Act section	Submission
			or a DOCA) there is no direct route from a restructuring or restructuring plan to liquidation, and that the company may therefore need to first return to normal control of its directors. This would create a "gap" between the restructuring or restructuring plan and the subsequent liquidation, such that it does not "immediately" follow those processes. This would make these voidable transaction provisions largely non-applicable (and possibly subject to manipulation), which we assume is not the legislative intent. This issues would largely be addressed if there was a direct route from a restructuring or restructuring plan into liquidation (as there is in the case of administration), and as we recommend in Submissions 7 and 28 above, such that there would normally be no such gap. We recommend this is done.
43	**Vesting of unperfected security interests**	588FL PPSA s 267	**Recommendation 43** • Amend s 267 of the *Personal Property Securities Act 2009* (Cth) (**PPSA**) so that security interests which are unperfected at the commencement of a restructuring will vest in the company. We note that the Exposure Draft amends s 588FL so that PPSA security interests not registered within time will vest in the company if the company commences a restructuring within 6 months of the date of registration. This is consistent with the approach to vesting in respect of the administration process which we think is appropriate. However no amendment has been proposed to the vesting provisions contained in s 267 of the PPSA. Section 267 provides that a security interest that is unperfected at the date of administration or liquidation will vest in the company. We think it would be consistent for security interests that are unperfected at the commencement of a restructuring to also vest under s 267 of the PPSA.

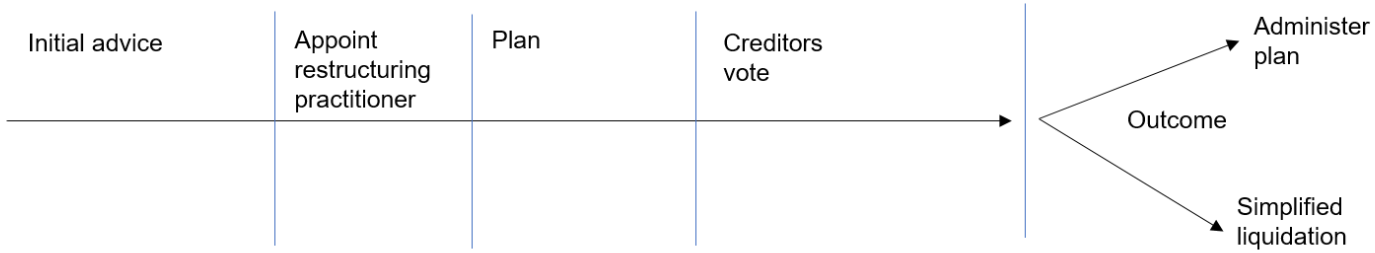
	Topic	Proposed new or amended Corporations Act section	Submission
44	**Automatic vesting of PPSA security interests granted under the date of administration or restructuring**	588FL	**Recommendation 44** • Amend s 588FL(4) to provide that the security interest shall not vest if it is granted by the company after the critical time with the consent of the administrator, deed administrator, restructuring practitioner or liquidator (as applicable). There is currently a technical issue that arises under s 588FL of the Corporations Act in respect of any security interested granted after the date of the administration, which causes that security interest to 'vest' (become invalid) even if the security interest was granted by an administrator as part of an administration funding package. These funding packages are frequently critical to the success of the administration. This has resulted in administrators needing to seek court orders to ensure such security will be valid whenever such new security is to be granted. A similar issue will arise in respect of security granted after the start of a restructuring under the Exposure Draft. Section 588FL of the Corporations Act, which deals with the automatic vesting of a PPSA security interest, has the effect that if a registration is not made within the time set out by s 588FL(2)(b), the security interest vests in the company. Under s 588FL(2)(b)(ii), the deadline for registration is the latest of the following times: • 6 months before the 'critical time'; • the time that is the end of 20 business days after the security agreement that gave rise to the security interest came into force, or the time that is the critical time, whichever time is earlier; • if the security agreement giving rise to the security interest came into force under the law of a foreign jurisdiction, but the security interest first became enforceable against third parties under the law of Australia after the time that is 6 months before the critical time – the time that is the end of 56 days after the security interest became so enforceable, or the time that is the critical time, whichever time is earlier; • a later time ordered by the court under s 588FM. If an administrator wishes to provide security as part of an administration funding, the effect of s 588FL is that the security will vest in the company, as the 'critical time' is the date which the

Topic	Proposed new or amended Corporations Act section	Submission
		administrator was appointed under s 513C, unless a later time is ordered by the court under s 588FM. As a result, an administrator who intends to provide security as part of an administration financing transaction must incur the cost and delay of seeking an order from the court under s 588FM of the Corporations Act to avoid the security vesting in the company (see, for example, *Korda, in the matter of Ten Network Holdings Ltd (admin apptd) (rec and mgr apptd)* [2017] FCA 1144 and *K.J. Renfrey Nominees Pty Ltd (Trustee), in the matter of OneSteel Manufacturing Pty Ltd v OneSteel Manufacturing Pty Ltd* [2017] FCA 325). Ultimately, whether an administrator considers that it is in the best interests of a company and its creditors to provide security during the course of an administration is a commercial decision that should fall within the wide role given to administrators under s 437A of the Corporations Act, and an administrator who is empowered to sell the entire business without seeking an order from the court should not be required to approach the court. Whilst this is an issue that has to date arisen in respect of administrations, the drafting of the current legislation and the Exposure Draft means that this issue will also apply to any security granted by the company during the restructuring. As noted in Submission 20 above, the grant of security during this period should be carefully prescribed and require the consent of the restructuring practitioner in most cases. However, there will be cases where it is appropriate and important for such funding to be provided on a secured basis. To avoid these vesting issues we recommend s 588FL is amended to address this issue in the case of both administration and restructurings. The amendment should provide that s 588FL(4) should not apply in respect of security that is granted by the company after the critical time with the consent of the administrator, deed administrator, restructuring practitioner or liquidator (as applicable).

	Topic	Proposed new or amended Corporations Act section	Submission
45	**Remuneration of restructuring practitioner**	Proposed Insolvency Practice Rule 60-18	**Recommendation 45** • Provide an appropriate, transparent framework for the remuneration of restructuring practitioners in respect of a restructuring or a restructuring plan. • Consider provision of Government funding to meet the costs of the restructuring process or simplified liquidation in appropriate cases where sufficient funding is not otherwise available. The Exposure Draft does not provide a framework for the remuneration of restructuring practitioners in respect of a restructuring or a restructuring plan. However, the Exposure Draft introduces a new s 60-18 into the Insolvency Practice Schedule which enables the Insolvency Practice Rules to provide for and in relation to the remuneration of a restructuring practitioner for a company and for a restructuring plan. We also note that the fact sheet previously released by the Government stated that the restructuring practitioner would propose a flat fee for their work in helping a business develop a restructuring plan, and that the fee for administering the restructuring plan would be provided for in the restructuring plan. We also understand that the Government prefers a competitive market based approach to price setting. Detailed consideration will need to be given to the remuneration of restructuring practitioners. For small businesses, if the fees payable to restructuring practitioners are too high, then restructuring may be unaffordable and this could jeopardise any return to creditors. Conversely, if the fees are too low, there may be little market interest in undertaking this new role. Market pricing may also be impacted by the complexity and amount of work involved and the degree of risk involved. Disclosure and transparency of fees will be important. However it should be noted that a purely market based approach may not deliver satisfactory results given that: • for small companies, the cost of the work may be disproportionate to (or even exceed) the assets of the company;

	Topic	Proposed new or amended Corporations Act section	Submission
			• directors may be less incentivised to pursue the lowest price as opposed to restructuring practitioners who can promise particular outcomes (such as avoiding personal liability or retaining ownership of the business) given that the costs of the process will effectively fall on creditors rather than shareholders where the company is insolvent. Consideration should be given to whether Government funding will be available to meet the costs of the restructuring process (or the simplified liquidation) in appropriate cases where sufficient funding is not otherwise available. In this regard we note recommendation 7 from the UNCITRAL Text which states: *"The insolvency law providing for a simplified insolvency regime should specify mechanisms for covering the costs of administering simplified insolvency proceedings where assets and sources of revenue of the debtor are insufficient to meet those costs."* We also note the further comments at paragraphs [50]–[51] of the UNCITRAL Text in this regard. Successful, fair and efficient restructuring and insolvency processes have significant external benefits to the broader business community, the economy and the public in general, and therefore public funding should be made available to achieve these broader beneficial outcomes.
46	**Temporary relief for companies seeking a restructuring practitioner**	Schedule 2	**Recommendation 46** • Provide further details in relation to temporary relief for companies seeking to appoint a restructuring practitioner. The Exposure Draft contains a new Schedule 2 (Temporary relief for companies seeking a restructuring practitioner) which is blank. We assume from the fact sheet previously released by the Government that the purpose of this Schedule will be to enable small businesses to apply for temporary relief from insolvent trading liability and around responding to statutory demands from creditors. We are unable to comment on this Schedule until further details are provided.

Appendix 1: Skills matrix and capability approach – restructuring practitioner



Designated adviser	Initial advice	Appoint	Plan	Vote	Outcome
Existing adviser (lawyer / accountant)	Yes	No	No	No	No
Independent generalist (lawyer / accountant)	Yes	No	No	Yes *	No
Independent specialist (e.g. accredited member professional association)	Yes	Yes*	Yes*	Yes*	Yes* (for plan) No for liquidation unless a registered liquidator
Registered liquidator	Yes	Yes*	Yes*	Yes*	Yes*

New class: restructuring practitioner

* Experienced accountant with insolvency / restructuring experience (who may or may not be a registered insolvency practitioner or meet the current requirements) could ensure compliance with regulations and reporting