CORPORATE INSOLVENCY

Corporate governance is complemented by an effective treatment of insolvency. The G22 Working Group on International Financial Crises noted that, in addition to contributing to crisis prevention, strong and predictable insolvency regimes are an important element of crisis mitigation and orderly crisis resolution.

Institutional framework

The law dealing with corporate insolvency is contained in the Corporations Law. The relevant provisions are primarily concerned with procedures for the winding up of companies, the orderly realisation of the available assets of those companies and the equitable distribution of the proceeds to creditors (including employees) and shareholders. There are also provisions governing the appointment of receivers or other persons who are entitled to assume control over particular assets of the company, the reconstruction of companies, arrangements and compromises with creditors and the voluntary winding up of solvent companies.

Corporate insolvency administrations are generally conducted by specialised accounting professionals who are licensed to conduct corporate external administrations by the Australian Securities and Investments Commission (ASIC). Some types of administrations involve a significant supervisory role for the court while others, notably voluntary administration, have the court play a lesser role. However, ASIC has an overall supervisory jurisdiction.

Under Australian law there are generally four types of external administration of insolvent companies:

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

Directors of insolvent companies have to consider the options for external administration because they are under a legal obligation to

cause an insolvent company to cease trading. If they fail to do so they may be held personally liable for the company's debts.

Liquidation

Liquidation, or winding up, is a procedure by which a corporation is ultimately dissolved. Generally, upon a liquidation, the liquidator takes complete control of the corporation from the directors. The objective of a winding up is to bring about an end to the corporation in an orderly and equitable manner which obtains the maximum return possible for creditors and members.

Liquidation can commence at the instigation of the company, or in some circumstances by a court on the application of a creditor or some other interested party. It can also be entered into following a voluntary administration (discussed below).

A liquidator is required to report not only to the creditors and members of the corporation, but also to ASIC. In some circumstances there is a particular responsibility to report suspected breaches of the law by company officers.

Receivers and other controllers

Receivership is usually instituted by a secured creditor appointing an insolvency practitioner as receiver to enforce the security. The receiver acts primarily for that creditor's benefit. A receivership may be general — where the property constituting the security is the company's business and the whole, or substantially the whole, of its property. A receivership may be particular — where the receiver is appointed to take control of a particular piece of property and there is no reason for the directors to relinquish direction of the company's affairs.

A receiver is also a manager (that is, a receiver and manager) if he/she has power to manage the affairs of the corporation as well as take possession of particular items of property.

Australian law also allows other 'controllers' to enforce a security. Controllers are subject to some of the duties imposed by the law on receivers. A controller may be the secured creditor itself enforcing the security for itself or an agent for the secured creditor.

The activities of receivers of corporate property are regulated under the Corporations Law, which contains a number of statutory powers and obligations. Some of the relevant provisions deal exclusively with receivers, while others apply to controllers generally.

Voluntary administration

The voluntary administration provisions in the Corporations Law give legislative backing to a procedure in which a company may reach an agreement with its creditors to compromise or defer debts. If an arrangement can be successfully negotiated between a company and its creditors, the arrangement will be set out in a deed of company arrangement, which binds the company and the creditors. If these attempts fail, the legislation facilitates the transition from voluntary administration to winding up.

The objective of the voluntary administration scheme is to allow the business, property and affairs of an insolvent company to be administered 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.

The voluntary administration scheme is now the most common means of dealing with companies in financial difficulty.

Scheme of arrangement or reconstruction

The Corporations Law provides for a mechanism by which a corporation may enter into a legally enforceable scheme of arrangement or compromise with its creditors. The usual aim of a scheme of arrangement is to allow a company to reach an agreement with its creditors (and possibly its members) to bring about a more beneficial situation for the company's creditors (and, more usually, the company) than would otherwise be the case. It may avoid an impending insolvency administration or set aside an existing administration. This arrangement or compromise must be approved by creditors at meetings duly convened in accordance with the Corporations Law and sanctioned by order of a court. An application to the court to order the necessary meetings to consider a scheme of

arrangement or compromise may be made by the corporation, a creditor, a member or a liquidator.

Since the introduction of the voluntary administration scheme, schemes of arrangement are used rarely, if ever, for the sole purpose of effecting compromises with creditors. However, as the scheme of arrangement provisions may also be used for other purposes involving members' rights such as reconstructions which involve varying share structure or amalgamations, a scheme of arrangement may be more suitable than other forms of external administration in those particular circumstances.

Transparency

There are currently no recognised detailed standards for domestic laws governing insolvency. However, in its October 1998 report the G22 Working Group on International Financial Crises identified some key features and principles important to an effective insolvency regime.

Australia has a national insolvency regime that is substantially consistent with the key features and principles identified by that Working Group. Further detail is in Attachment G.