MinterEllison

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Manager
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The Treasury
Langton Crescent
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Dear Sir/Madam

Submissions in response to 'Helping Companies Restructure By Improving Schemes of Arrangement' paper dated 2 August 2021

We refer to the Treasury's paper 'Helping Companies Restructure By Improving Schemes of Arrangement' dated 2 August 2021 (**Consultation Paper**) inviting submissions on the issues raised in the Consultation Paper.

MinterEllison thanks the Treasury for the opportunity to make these submissions on the Consultation Paper.

In our view there are improvements to Australian creditors' schemes that should be considered by the Government including an interim automatic moratorium, priority for rescue or debtor in possession finance, cross-class cram downs and pre-pack schemes.

Many of these proposed changes would more closely align the position in Australia with that which prevails in equivalent jurisdictions, such as the United Kingdom and Singapore.

Australia has robust restructuring and insolvency laws. To continue attracting international capital, changes should always be considered so they keep pace with the developing expectations of what is emerging as a global restructuring market.

However, any specific change needs to be considered in a holistic context of the existing and somewhat unique aspects of Australian law, such as the ipso facto stay and its exceptions, the unfair preference provisions and the directors' indemnity in favour of the Commissioner of Taxation in respect of voidable transactions, liability for insolvent trading and access to the insolvent trading safe harbour protection for directors. Consideration also needs to be given to the consequences for stakeholders of an attempted or failed restructure by way of creditors' scheme.

All these matters warrant meaningful engagement between the Government and interested parties by way of further consultation with Treasury or through a Parliamentary inquiry prior to any draft legislation being released.

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We set out below MinterEllison's responses to the specific questions posed by Treasury in the Consultation Paper, noting that the views expressed in these submissions do not represent the views of MinterEllison's clients.

At the outset, we note that creditors' schemes for the purposes of restructuring need to be distinguished from their use as alternate distribution mechanisms to liquidation. Many creditors' schemes have historically been used from within existing insolvency procedures without any purpose of avoiding liquidation.[1] The focus in these submissions is the proposed use of creditors' schemes for restructuring purposes[2], especially as a potential alternate option to voluntary administration (**VA**).

Responses to list of questions

Question 1 – Should an automatic moratorium apply from the time that a Company proposes a scheme of arrangement? Should the automatic moratorium apply to debts incurred by the Company in the automatic moratorium period?

Creditors' schemes under Part 5.1 of the *Corporations Act 2001* (Cth) (**Act**)[3] are not commonly used in Australia as a means of restructuring insolvent companies, in comparison to VA under Part 5.3A.

There are however advantages of creditors' schemes over VA as a means of restructuring insolvent entities including that the company avoids external administration, there is no requirement that the company is or likely to become insolvent, the directors and management can stay in control of the company, the scheme can bind only limited classes of creditors (including secured creditors), and may also affect creditors' claims against third parties. There is also no express provision to materially vary, or set aside or terminate a scheme once it has been approved and has become effective[4] (however the Court has an inherent power in connection with its own processes[5]) providing greater certainty of outcome for all stakeholders. These differences are significant in some cases.

Albeit there is a lack of empirical evidence, the infrequent use of creditors' schemes as compared to VA may be due to the fact that in most cases creditors' schemes are not as simple, quick and cheap as VA and a restructuring by executing a deed of company arrangement (**DOCA**), and the benefits are simply not relevant to many companies.

The trend may also be attributable in part to an important distinction between creditors' schemes and VA – creditors' schemes do not attract an automatic moratorium or stay of proceedings, whereas VA does.

The point should be made that in many cases a VA does not lead to a restructuring through a DOCA: the company is hopelessly insolvent, there is no DOCA proposal and the company proceeds to liquidation. We cannot see how the option of a creditors' scheme for which there is an automatic moratorium or stay of proceedings would avoid liquidation and lead to a different outcome.

That being said there is no single, preferred approach. Maximising the chance of a successful corporate restructuring benefits from there being a wide range of options. One size does not fit all.

Power of the Court to restrain further proceedings under s 411(16)

We note that the Consultation Paper states "*[w]hile 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*".[6] Although creditors' schemes do not currently attract an automatic stay, the Court has power under s 411(16) to "*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*" provided a creditors' scheme has been proposed by the entity and no order has been made or resolution passed for its winding up.

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[1] See e.g. *Re Opes Prime Stockbroking Ltd (No 2)* (2009) 73 ACSR 411; [2009] FCA 864; *Re Lift Capital Partners Pty Ltd (in liq) (No 2)* [2010] FCA 84; *Re Lehman Brothers Australia Ltd (in liq) (No 2)* (2013) 95 ACSR 685; [2013] FCA 965.
[2] See e.g. *Re Nine Entertainment Group Ltd (No 2)* [2013] FCA 40; *Re Atlas Iron Ltd (No 2)* [2016] FCA 481; *Re Emeco Holdings Ltd* (unreported, Federal Court of Australia NSD101/2017); *Re Boart Longyear Ltd (No 2)* (2017) 122 ACSR 437; [2017] NSWSC 1105; *Re BIS Finance Pty Ltd; Artsonig Pty Ltd* [2018] NSWSC 3; *Re Tiger Resources Limited (No 2)* [2020] FCA 266; *In the matters of Boart Longyear Limited* [2021] NSWSC 982.
[3] In this submission references to sections are to sections of the Act.
[4] A scheme becomes effective once a copy of the Court orders under s 411(4)(b) is lodged with ASIC: s 411(10) .
[5] See e.g. *Re AGL Gas Networks Ltd* (2001) 33 ACSR 441; [2001] NSWSC 165 at [26]-[47].
[6] Consultation Paper, p 5.

The purpose of s 411(16) and an order made pursuant to it is to protect the assets of the company pending the possible adoption of the scheme.[7] An order under s 411(16) restrains any proceedings whether by action or other civil proceeding against the company the subject of the scheme, whether or not such action or proceeding has already been commenced, and the purpose of such an order is to promote the orderly and efficient consideration of a scheme.

In exercising its discretion under s 411(16), the Court has regard to matters including whether a compromise or arrangement has been proposed between a Part 5.1 body and its creditors or any class of them; the risk that individual steps taken by creditors could give rise to a preference or bring about the frustration of the procedure provided by s 411 to bring about a compromise of creditors' claims against a company, potentially forcing it into VA or winding up; the degree of creditor support for the proposed scheme; and the likely return to creditors under the proposed scheme compared to the return likely to be received under a winding up.[8]

Further, as was not uncommon prior to the commencement of VA in 1993, an entity may apply to the Court to have a provisional liquidator appointed, which would afford a limited moratorium pending the final hearing of the winding up application, during which time a creditors' scheme may be capable of being proposed to avoid liquidation at the winding up hearing. In the context of restructuring schemes, that practice was supplanted by VA which affords a more extensive moratorium, does not require that a company be insolvent at the time they appoint a VA (it is sufficient that the directors resolve that it may become so in the future) and was generally thought to be generally less complex, quicker and cheaper.

Should an automatic moratorium apply for creditors' schemes?

Given the Court's power under s 411(16) to restrain further proceedings once a scheme has been proposed, which is to be exercised judicially having regard to the Court's supervisory role in creditors' schemes,[9] it is arguable that an automatic stay such as that which applies in VA under Part 5.3A[10] may not be appropriate because, unlike VA and liquidation, creditors' schemes are inherently Court-supervised processes, and the Court already has the power to make restraining orders under s 411(16). Further, unlike VA and DOCAs a creditors' scheme need not involve all creditors of the entity. Creditors' schemes often relate to particular debts and claims of limited categories of creditors, e.g. the secured or unsecured finance creditors to the exclusion of trade creditors and employees, whose rights sit outside the scheme and who are effectively made whole and paid in full whilst the scheme is implemented.[11] Creditors' schemes are also routinely proposed by solvent companies to reconstruct options and widely held debt securities. Any automatic moratorium should not apply to these kinds of creditors' schemes. The ability to conduct a targeted or limited restructure is one of the key features of creditors' schemes that make them more attractive in certain cases than VA and a DOCA which affect all classes of creditors (albeit in varying degrees).

Moreover, there is scope for the potential abuse of an automatic stay of the kind which applies in VA in that the scheme entity under the control of its directors and remaining in possession of its assets may seek to abuse the moratorium to delay or prejudice creditors in circumstances where the proposed scheme lacks certainty, a sufficient level of creditor support and/or it is not in a form that can be put before the Court to enable it to exercise its discretion under s 411. Appropriate safeguards would be required to prevent such conduct. The guiding principle should be that creditors should have their rights suspended only to the extent necessary to preserve the status quo while a restructuring proposal is being formulated and voted on.

Additionally, the company already has the benefit of a significant degree of protection, because of the (relatively) recently introduced s 415A (ipso facto stay for creditors' schemes for avoiding insolvent liquidation), under which counterparties to contracts with the company (such as leases) cannot terminate or exercise other rights under those contracts simply because the company has announced it is proceeding with an application under s 411 for the purpose of avoiding being wound up in insolvency, albeit that until 30 June 2023 these provisions only apply to contracts entered into or amended after 1 July 2018. Comparisons with schemes of arrangement in other jurisdictions need to be cognizant of the different ways these kind of (ipso facto) provisions operate in those places.

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[7] _In the matter of Boart Longyear Limited_ (2017) 121 ACSR 377; [2017] NSWSC 756 at [12], citing _Re GAR Pty Ltd_ [1962] VicRp 37; [1962] VR 252, 256; _Playcorp Pty Ltd v Venture Stores (Retailers) Pty Ltd_ (1992) 7 ACSR 193.
[8] _In the matters of Boart Longyear Limited_ [2021] NSWSC 982 at [52]; _Re Glencore Nickel Pty Ltd_ (2003) 44 ACSR 210; [2003] WASC 18 at [67]; _Re Boart Longyear Ltd_ (2017) 318 FLR 226; [2017] NSWSC 537 at [11].
[9] See e.g. _Australian Securities Commission v Marlborough Gold Mines Ltd_ (1993) 177 CLR 485 at 498; [1993] HCA 15.
[10] Act, s 440D.
[11] See e.g. _In the matters of Boart Longyear Limited_ [2021] NSWSC 982.

On the other hand Australian creditors' schemes may be further improved by the introduction of a supplementary automatic moratorium to the current stay power under s 411(16), whereby an interim stay applies when an entity proposes a creditors' scheme to avoid being wound up in insolvency with effect for a limited period of time, e.g. 30 business days or until the first Court hearing (i.e. the hearing of the scheme meeting convening application under s 411(1)). To satisfy the requirement of avoiding insolvency, it may be appropriate to require the directors to make a written declaration that the creditors' scheme is for the purpose of the company avoiding being wound up in insolvency and to lodge that declaration with ASIC and the Court.

We would suggest conditions to the moratorium include that the entity lodge a statutory notice with ASIC attaching a copy of a Court filed originating process under s 411 for a creditors' scheme of arrangement for the purpose of avoiding being wound up in insolvency, together with supporting affidavit evidence of (a) the directors' opinion that the proposed creditors' scheme would result in a better outcome for the company than the immediate appointment of an administrator, or liquidator, of the company, (b) a show of significant creditor support for the proposed scheme and how such support would be important for the scheme being agreed to by requisite majorities (i.e. that they are likely to be satisfied), and (c) an advanced draft explanatory statement in relation to the scheme as required by s 412(1)(a) as submitted to ASIC for review under s 411(2).

In the alternative, it might be considered appropriate that directors be able to access an automatic stay from the time when the board resolves to implement a creditors' scheme (as evidenced by a filing to that effect with ASIC). In addition, there could be a preliminary process filed with the Court that allows proceedings to be commenced with respect to a scheme within a certain time (subject to extension by order).

Careful consideration would need to be given as to whether other preconditions are appropriate to protect stakeholders who might otherwise be adversely affected if a scheme is promoted and fails. This might include that the scheme company has all tax filings up to date and employee entitlements are being paid as and when they fall due (mirroring the safe harbour conditions in s 588GA(4)); and the directors estimate, having made all reasonable inquiries, that the company has sufficient cash, credit and liquid resources to meet all anticipated debts expected to be incurred or payable during the initial 30 business day period.

If the prescribed threshold conditions are met, the automatic interim stay would apply for a relatively short period until the first Court hearing, unless the Court orders on application by an interested person that the stay be lifted (either entirely or on a limited basis to enable that creditor to proceed as against the entity) on the ground that it is appropriate in the interests of justice for the Court to do so, which we would expect to be primarily in circumstances where the Court is satisfied that creditors are likely to receive a better return in liquidation than under the proposed scheme. At the first Court hearing the Court would consider whether to grant an extension of the moratorium, and have the discretion to make conditions or grant a further extension as the Court thinks fit including to extend the stay to operate in respect of holding or subsidiary companies of the scheme company if they play a necessary and integral role in the compromise or arrangement and where an action being taken against the subsidiary or holding company will frustrate the scheme. The Court could also have power to limit the stay to identified creditors or a class of them.[12] A safeguard on the exercise of this power could be that the Court needs to be satisfied that creditors of those entities will not be unfairly prejudiced by the stay. Further, as is the case under Singaporean law, to avoid potential misuse the automatic interim moratorium should only be available once in each 12 month period.

Careful consideration needs to be given as to whether the scope of an automatic stay in creditors' schemes should extend beyond continuing proceedings against the debtor, beginning or proceeding with an enforcement process except in accordance with leave of the Court and in accordance with such terms (if any) as the Court imposes.[13] Should they mirror and be subject to the safeguards that apply during VA under Part 5.3A?[14] One difficulty with transposing these to the scheme context, is the lack of analogue for the safeguards afforded by VAs having a personal liability for debts incurred in the business and for property used by or in possession of the company under ss 443A and 443B. We would assume that directors would seek to exclude their own potential personal liability by pursuing a safe harbour regime (s 588GA) while the scheme is being implemented. Given these factors we would see benefit in the automatic moratorium being subject to review by the Court in the manner outlined above.

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[12] The Court has power to make s 411(16) restraining orders "subject to such terms as the Court imposes" which means that orders can be made in relation to specifically identified creditors including scheme creditors: see e.g. the first hearing orders made by the Court in *In the matters of Boart Longyear Limited* [2021] NSWSC 982.

[13] See e.g. the protections of company's property during VA under Division 6 of Part 5.3A.

[14] See e.g. the rights of secured parties, owners or lessors during VA under Division 7 of Part 5.3A.

As is the case under the recently enacted United Kingdom standalone moratorium[15], it may also be an appropriate balance to protect creditor interests to generally exempt the entity's secured finance creditors from the automatic stay, with exceptions by Court order for example on the ground that it is appropriate in the interests of justice to do so. Such exemption would likely result in standstill or forbearance arrangements being entered into by the debtor scheme company with secured creditors.[16] Again, careful consideration will need to be given to the scope of any secured creditor exemption, including whether it applies only to creditors with all asset security, or also applies to creditors with specific security interests including purchase money security interest creditors, and how it interacts with the ipso facto stay and the exemptions as they apply to different categories of secured creditors (i.e. those who have all asset security, who enforce before the scheme was announced or application was made, or hold security against perishable property).

The Singapore and United Kingdom automatic stay models

In Singapore[17] a debtor company can obtain a 30 day creditor moratorium while it pursues a creditors' scheme upon application to Court provided that it can show evidence that it is intending to propose a scheme and the applicable statutory requirements are met. Within the 30 day period after the filing the Court will schedule a first hearing to consider the views of the creditors (if any) and to decide whether to grant a further extension to the moratorium, at which time the debtor is required to provide evidence of creditor support, a list of all secured creditors and the 20 largest unsecured creditors and if the scheme has not yet been proposed an outline of the intended scheme which is sufficient for the court to assess whether it warrants being put to the creditors. It is also possible under Singaporean creditors' schemes for the Court to extend the automatic stay to operate worldwide if the Court is able to exercise jurisdiction over the relevant person, and to operate in respect of holding or subsidiary companies of the scheme company if they play a necessary and integral role in the compromise or arrangement and where an action being taken against the subsidiary will frustrate the scheme.

In contrast to the above approaches, in the United Kingdom a standalone moratorium was recently introduced that is not linked to creditors' schemes or any restructuring or insolvency process. The standalone moratorium operates for a period of 20 business days subject to extension during which the company is overseen by a monitor being an insolvency practitioner. In our view, a standalone moratorium would not be appropriate if the Government's objective is to improve Australian creditors' schemes because a standalone moratorium would be divorced from a clear pathway leading to a restructure through a scheme.

Should the stay apply to debts incurred during the automatic stay period?

In our view, it is appropriate that any interim automatic stay apply to a limited category of obligations and debts incurred during the moratorium period owed to the scheme creditors only to allow the debtor a moratorium from scheme creditor enforcement to attempt to implement a proposed creditors' scheme. In order to encourage non-scheme creditors and trade creditors to do business with the entity and assist it in implementing the scheme, the debts incurred by the entity in the normal or ordinary course of its business should not be subject to the stay.

However, such debts incurred by the entity in the normal or ordinary course of its business during the period from when the interim automatic moratorium applies until it is lifted or such time as the scheme is implemented or discontinued should be afforded priority unsecured creditor status under s 556(1) in the event that the scheme is discontinued by the entity or it is not approved by scheme creditors and/or by the Court under s 411 and the entity becomes subject to external administration.

There is also a potential perverse impact on creditors whose debts are being paid in the normal course whilst a creditors' scheme is being propounded to avoid insolvency, those payments may be liable to be set aside as unfair preferences under s 588FA and voidable transactions under s 588FE(2) in the event that the scheme fails and the company is wound up thereafter. It may be considered appropriate that the unfair preference and voidable transaction provisions be amended to exempt such payments from being voidable in a liquidation if the scheme fails.

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[15] The *Corporate Insolvency and Governance Act 2020* (United Kingdom) introduced a new standalone moratorium in new Part A1 of the *Insolvency Act 1986* (UK).
[16] Standstill or forbearance agreements are common in the context of Australian creditors' schemes, see e.g. pursuant to clause 10 of the Restructuring Support Agreement dated 12 May 2021 entered by the parties in *In the matters of Boart Longyear Limited* [2021] NSWSC 982 (a copy of that agreement is available for download from the ASX Market Announcements Platform).
[17] *Companies Act (Cap 50) 2006* (Singapore), s 210.

As noted above, the Government may consider it an appropriate balance to protect creditors' rights to allow the entity's secured finance creditors to be generally exempted from any automatic stay. The scope of any exemption from that, would then require careful consideration.

Finally in this context, we note that the recently introduced restructuring process in Part 5.3B has also aligned secured creditor rights with those that exist in VA.

Question 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?

As discussed in our response to Question 1 above, we consider that any automatic stay in the context of creditors' schemes operate on an interim basis and be subject to the Court's review to reflect the Court supervised process under a creditors' scheme. However, as above, we consider there are existing elements of Part 5.3A regarding the scope and exceptions to the VA moratorium provisions which may be relevant to the framework of a creditors' scheme automatic stay. Whether any stay of proceedings should apply only to proceedings before a court,[18] or also before tribunals or arbitrations warrants consideration. The appropriateness of the exemptions also needs to be addressed on a holistic basis, taking into account the operation of ss 443A and 443B (VA personal liability), as well as s 415D (ipso facto stay for creditors' schemes for avoiding insolvent liquidation) and its exceptions.

The Court should be given the power to lift all or part of any automatic stay in circumstances where it is appropriate in the interests of justice for the Court to do so (e.g. the scheme becomes unlikely to proceed and/or the continuation of the stay is delaying creditors which is causing prejudice to pre-petition creditors where further indebtedness is being incurred in the stay period), and in this regard we expect the Court would determine such applications with regard to the principles enunciated in the case law on leave to proceed against a company in voluntary administration under Part 5.3A.

Question 3 – When should the automatic moratorium commence and terminate? Are complementary measures (for example, further requirements to notify creditors) necessary to support its commencement?

As stated in our response to Question 1 above, we consider that the automatic stay should commence when the entity has lodged a statutory notice with ASIC attaching a copy of a Court filed originating process under s 411 for a creditors' scheme, for the purpose of avoiding being wound up in insolvency, including a copy of the supporting affidavit evidence including at least the threshold matters that we have suggested in our response to Question 1 above. We have also suggested in our response to Question 1 above some alternative processes by which the commencement of an automatic stay might be brought forward.

The automatic stay should immediately terminate if the prosecution of the scheme is discontinued by the entity or it is not approved by scheme creditors and/or the Court under s 411, or otherwise if the Court makes an order lifting the stay or if it lapses due to no extension order having been made.

In terms of giving notice to affected persons, scheme entities who are accessing the automatic moratorium should be required to lodge notice in a prescribed form on ASIC's published notices website by no later than 10.30am on the business day after the stay commences that it is undertaking a creditors' scheme and is relying on the moratorium, and send a prescribed form of electronic notice to that effect by email communication to all known creditors and members of the entity, any employees and other applicable regulators and governmental bodies within a business day after the stay commences which includes a statement that they are entitled to apply to Court to lift the automatic stay and where they can find information about their rights to make such an application.

Question 4 – How long should the automatic moratorium last? Should its continued application be reviewed by the Court at each hearing?

As stated in our response to Question 1 above, in our view the automatic interim stay should apply for a relatively short period e.g. 30 business days or until the first Court hearing at which time the Court should consider whether it is appropriate that the stay continue in effect until the second Court hearing. We consider that the Court should also be granted ancillary powers to make orders providing for such incidental matters as are necessary to ensure that the creditors' scheme is fully and effectively carried out which we

[18] See, e.g., s 440D.

would expect to include similar powers available under the Singaporean creditors' schemes legislation including to extend the automatic stay to operate worldwide if the Court is able to exercise jurisdiction over the relevant person, and to operate in respect of holding or subsidiary companies of the scheme company if they play a necessary and integral role in the compromise or arrangement and where an action being taken against the subsidiary will frustrate the scheme. A safeguard should be that the Court must be satisfied that creditors of those entities will not be unfairly prejudiced by the stay.

Question 5 – Are additional protections against liability for insolvent trading required to support any automatic moratorium?

In general terms, we consider that the current defences to insolvent trading especially s 588GA (safe harbour) coupled with s 415D (ipso facto stay for creditors' schemes for avoiding insolvent liquidation) should be sufficient.

We note the Government's appointment of the Safe Harbour Review Panel to review the current insolvent trading safe harbour laws. We consider it appropriate that the panel also review the overall effectiveness of Australia's insolvent trading laws more generally given Australia currently has amongst the strictest insolvent trading laws in the world, especially compared with wrongful and fraudulent trading laws in force in other common law jurisdictions.[19]

That being said, insolvent trading is one of several types of personal liability for directors that can arise when a company is in the zone of insolvency and is attempting a restructure that may or may not succeed.[20] A holistic analysis should ideally be completed which considers whether additional protections are required for directors under s 588FGA and the director penalty regimes under the taxation legislation.

If a company is able to access the moratorium even if it has outstanding tax debts or returns, there is policy choice as to whether the directors should be able to escape or mitigate personal liability by triggering the scheme process. Or, is it better that s 588FA (unfair preference) be abolished or amended, so that s 588FGA has no work to do, so that directors are not exposed to the risk of personal liability for ensuring that taxes are paid?

In this context and generally we consider there would be utility in the Government considering more broadly whether the unfair preference laws actually achieve their intended purpose of creating equality amongst unsecured creditors and (if not) be repealed or amended generally.[21]

Question 6 – What, if any, additional safeguards should be introduced to protect creditors who extend credit to the Company during the automatic moratorium period?

As stated in our response to Question 1 above, we consider that debts incurred by the entity in the normal or ordinary course of its business during the period from when the interim automatic stay applies until it is lifted or such time as the scheme is implemented or discontinued should be afforded priority unsecured creditor status under s 556(1) in the event that the scheme is discontinued by the entity or it is not approved by scheme creditors and/or by the Court under s 411 and the entity becomes subject to external administration. Additional protection may be achieved by denying access to the automatic stay if the company is unable to pay normal or ordinary course of business creditors as and when they fall due.

We have also suggested above potential amendments to the unfair preference laws so that payments made to such creditors would be not be voidable if the scheme fails and the company is wound up.

Consideration could be given to revisiting the ipso facto rules to expressly recognise the right of a supplier of goods or services on credit to insist on adequate assurance of payment after the initial application is filed and suspend service or delivery if it is not promptly provided.[22]

In relation to rescue finance creditors, we consider that there is merit in a new super priority regime for debtor in possession (**DIP**) finance in the context of Australian creditors' schemes. This is a United States Chapter 11 concept that was introduced in Singapore creditors' schemes which allows new finance or

[19] In comparison to the wrongful and fraudulent trading laws of the United Kingdom, Singapore and Hong Kong. The United States does not have any laws comparable to the Australian insolvent trading laws.
[20] Act, s 588G.
[21] See e.g. *Badenoch Integrated Logging Pty Ltd v Bryant, in the matter of Gunns Ltd (in liq) (recs and mgrs apptd)* [2021] FCAFC 64 at [83]-[84] and [121] in which the so called peak indebtedness rule has been abolished.
[22] Such a concept is recognised in the United States under UCC § 2-609 and in the United Kingdom in the context of suppliers of essential services under the *Insolvency (Protection of Essential Supplies) Order 2015* (UK).

security to be provided or granted on the basis that the DIP finance can be repaid ahead of existing creditors given that such financiers are granted super priority security over the debtor's assets. The Court would operate as a safeguard on super priority for DIP finance and would allow super priority only if existing secured creditors receive adequate protection (on the basis that the Court is satisfied of evidence that the enterprise value of the company shows sufficient property to support the DIP finance and security), and no unfair prejudice to existing secured creditors on the basis that their estimated return in a liquidation would be less than under the scheme which requires DIP finance to be implemented.

A DIP finance super priority regime may assist debtors obtain new rescue finance that cannot be obtained or secured consensually, noting that it is possible to inject new money and grant priority security to DIP financiers by agreement of existing secured creditors.[23] The attraction of DIP finance has led to Australian companies utilising United States Chapter 11 bankruptcy to access DIP finance to effectuate a solvent restructure without external administration in circumstances where DIP finance is required to allow adequate liquidity for its business operations until a financial restructuring or recapitalisation can be completed.[24] We consider that if a DIP financing regime was available in connection with Australian creditors' schemes debtors may consider schemes more attractive to complete a financial restructuring or recapitalisation.

Question 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 consider that in appropriate cases where an insolvency practitioner (**IP**) assisting the company with a creditors' scheme is able to comply with the statutory and fiduciary obligations of a VA in an objective and impartial manner the IP should be permitted to act as VA in the event that the scheme fails i.e. it is voted down by creditors or is not approved by the Court at the second hearing.

Existing principles and judicial guidance should be sufficient to determine whether an IP can be appointed as VA, without enacting new provisions which are specific to a VA's involvement in any scheme process. The critical issue will be the nature and extent of that involvement, as opposed to its fact.

Whether an IP is sufficiently independent to take a VA appointment is dependent on the nature and extent of any pre-appointment assistance the IP has provided to the company, e.g. as a chief restructuring officer or a member of an ad hoc restructuring committee, as a safe harbour adviser (to the board), or as an author of an independent expert's report for the creditors' scheme or a potential scheme administrator if the scheme is approved. The requirements of these roles would have different effects on IP independence, and need to be assessed on a case by case basis.

As a fundamental principle, VAs are subject to obligations to be and be seen to act independently[25] and their conduct is subject to separate review by the Court.[26]

Further, leave of the Court is required under s 448C(1)(b) if the IP is a creditor of the company or of a related body corporate in an amount exceeding $5,000, other than in a capacity as VA, liquidator or DOCA administrator of the company or a related body corporate. The Courts apply a test of independence beyond that contained in s 448C pursuant to their traditional power to supervise external administrations.[27]

The principles that an IP must avoid real and potential conflicts of interests and duties owed to different parties, and be independent and seen to be independent, are relevant to the Court's discretion to grant leave under s 448C(1)(b). That disqualification provision is likely to apply in circumstances where the IP has done substantial pre-appointment work on behalf of the company in relation to a creditors' scheme before seeking to be appointed as VA of the company given that the IP is likely to be a creditor of the company in an amount exceeding $5,000 by the time has scheme failed and it is placed in VA. Where disqualification under s 448C applies, the Court must exercise its own judgment as to whether there is independence and an appearance of independence when the issue is raised.[28]

[23] See *In the matters of Boart Longyear Limited* [2021] NSWSC 982 at [10].
[24] Australian-incorporated and ASX-listed Speedcast International Limited recently decided to recapitalise under United States Chapter 11 bankruptcy proceedings to access DIP finance to implement a restructuring outside of external administration.
[25] See, e.g., section 3 of the *ARITA Code of Professional Practice: Insolvency Services* (approved on 16 September 2019, effective from 1 January 2020).
[26] Act, s 90-10 of Schedule 2 the Insolvency Practice Schedule (Corporations).
[27] *Ex parte Prior & Basedow* [2018] SASC 148.
[28] *Domino Hire Pty Ltd v Pioneer Park Pty Ltd (in liq)* (2000) 18 ACLC 13; [1999] NSWSC 1046.

The principles on which the Court acts in deciding applications under s 448C(1) include those applied by the Courts in determining the independence of IPs, namely (a) there must be a real and not merely theoretical possibility of conflict and that the guiding principle in the appointment by the Court of the IP is that he or she must be independent and must be seen to be independent; (b) those who assert that the IP should be removed are under a duty to establish at least a prima facie case that this is for the general advantage of the persons interested in the VA or liquidation and the onus of proof will not be easy to discharge if the IP has become well acquainted with the business and affairs of the company; and (c) the IP may act as a VA or liquidator of a company even if there is a prior involvement with the company provided that involvement is not likely to impede or inhibit the IP from acting impartially in the interests of all creditors or give rise to a reasonable apprehension that the IP might be so inhibited or impeded.[29]

The case law suggests that leave under s 448C(1)(b) will be granted if the Court is satisfied it is to the general advantage of creditors of the company that the IP be given leave to be appointed as VA.[30] In appropriate cases, where there are concerns as to potential lack of independence the Court may be satisfied that the interests of the parties can be protected by undertakings proffered by the IP to notify creditors of the circumstances giving rise to their appointment, and to approach the Court if any reasonable apprehension of conflict arises subsequent to their appointment as VAs.[31]

These provisions are also subject to the overriding right of creditors to vote to change the VA, or appoint a different liquidator, or apply to the Court under s 90-15 of the Insolvency Practice Schedule (Corporations).

Question 8 – Is the current threshold for creditor approval of a scheme appropriate? If not, what would be an appropriate threshold?

Under s 411 for a creditors' scheme to be considered for approval at a second Court hearing, it must first be agreed to by *each* class of creditor in the requisite majorities at a scheme meeting, being 75% by value and 50% by number voting in favour in person or by proxy. These thresholds mean that a minority dissenting or hold out class of (often subordinate) creditors may acquire a blocking stake and therefore have power to veto a scheme and effectively go against the wishes of a substantial majority of (often senior) creditors and thereby deprive a beneficial scheme of its value. In creditors' schemes disputes may arise regarding the composition of classes which are complex and may require court determination.[32] The Court does not have jurisdiction to approve a scheme if the classes have been incorrectly constituted.[33] Recently the Courts have relied on the variation power under s 411(6) which permits the Court to approve a scheme with "alterations or conditions as it thinks fit" to vary a scheme at the approval hearing or subsequent to the Court's approval and in a substantive and material way,[34] including to vary a creditors' scheme to address concerns raised by the Court at a first hearing as to whether the creditor classes are properly constituted.[35] An improvement could be to give the Court an express curative power in relation to schemes[36] which would allow the Court to approve schemes where there are insignificant errors in class composition.[37]

Cross-class cram downs where dissenting creditors are bound to the restructuring despite it not being approved by each class in the requisite majorities exist in comparable common law jurisdictions such as the United States, the United Kingdom and Singapore. In a sense they are already a feature of VA, because all creditors (irrespective of class and including secured creditors – the only class who might meet separately are employees if they are to receive a different treatment than in liquidation (s 444DA)) vote in a single meeting and a DOCA which discriminates between creditors or classes of creditors is permitted, provided that discrimination is not unfair (s 445D(1)(f)), when measured against the return the affected creditor would secure in a liquidation.[38]

In our view, a cross-class cram down procedure could be a valuable enhancement to Australian creditors' schemes.

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[29] *Re ACN NPD 008 144 536 Ltd* (2004) 49 ACSR 527; [2004] NSWSC 450 at [7], citing *Re St George Builders Hardware Pty Ltd* (1995) 18 ACSR 451 at 452.
[30] See e.g. *Re IMO Central Spring Works Australia Pty Ltd [No 1]* (2002) 34 ACSR 164; [2000] VSC 144; *Re Corrimal Leagues Club Ltd (in liq)* [2013] FCA 697.
[31] See e.g. *Re ACN NPD 008 144 536 Ltd* (2004) 49 ACSR 527; [2004] NSWSC 450 at [11].
[32] See e.g. *First Pacific Advisors LLC v Boart Longyear Ltd* (2017) 320 FLR 78; [2017] NSWCA 116.
[33] See e.g. *First Pacific Advisors LLC v Boart Longyear Ltd* (2017) 320 FLR 78; [2017] NSWCA 116 at [79].
[34] *Re Boart Longyear Ltd (No 2)* (2017) 122 ACSR 437; [2017] NSWSC 1105; *Wollongong Coal Ltd; Re Jindal Steel & Power (Australia) Pty Ltd* [2020] NSWSC 614.
[35] See e.g. *Re Tiger Resources Ltd* (2019) 141 ACSR 203; [2019] FCA 2186; *Tiger Resources Ltd v International Finance Corp (No 2)* [2020] FCA 266.
[36] The Court has wide powers under s 1322, however the Court's powers could be enhanced by an express curative power.
[37] We note that an express curative power of the Court in relation to schemes was recommended in Corporations and Markets Advisory Committee, "Members' schemes of arrangement", Report, December 2009, at 94 [5.4.5].
[38] *Commonwealth v Rocklea Spinning Mills Pty Ltd* (2005) 145 FCR 220; [2005] FCA 902 at [27].

Cross-class cram downs offer a range of benefits to make creditors' schemes more efficient and attractive. Reasons in support of this view include that cross-class cram downs (a) discourage greenmailing; (b) reduce concerns about creditor class composition; and (c) assist with creditor concerns about value leakage to shareholders.

Despite the benefits that cross-class cram downs may bring to Australia, it would be necessary to consider the rights, and ensure fair treatment, of the crammed down creditors. Mitigating features should include (a) ensuring the priority of secured debt over unsecured debt and equity (i.e. absolute priority), and protecting the property rights of secured creditors; (b) a requirement that crammed down creditors receive at least the equivalent of what they would receive in a liquidation; and (c) the power to authorise a cross-class cram down rest with the Court exercising its inherent fairness jurisdiction rather than the plurality of the voting creditors.

The Government could consider legislating cross-class cram down provisions similar to the Singaporean creditors' schemes model under which a cram down of an entire class of creditors can apply if (a) a majority in number of *all* creditors in *all* classes present and voting representing 75% in value have agreed to the scheme, (b) the scheme must have been approved by at least one class of creditors, and the Court is satisfied that the scheme does not discriminate between two or more classes and (c) the scheme is not unfairly prejudicial to each dissenting class on the basis that no dissenting creditors will receive less under the scheme then they would if the scheme is not approved.

Legislating cross-class cram for Australian creditors' schemes may assist in resolving difficulties in complex debt restructurings where class issues manifest and is likely to prevent greenmailing by minorities acquiring blocking stakes in the scheme debt which may result in value leakage from senior to subordinate creditors for the scheme to proceed.[39]

Question 9 – Should rescue, or 'debtor-in-possession', finance be considered in the Australian creditors' scheme context?

As stated in our response to Question 6 above, we consider that the availability of super priority for rescue or DIP finance in the context of creditors' schemes subject to appropriate safeguards to protect existing creditors' interests would improve Australian creditors' schemes as a means of restructuring insolvent entities.

Question 10 – What other issues should be considered to improve creditors' schemes?

In addition to the matters set out in our response to Question 8 above, we consider that 'pre-pack' schemes similar to the procedure available under Singaporean creditors' schemes would be useful to introduce to save the complexity, time and costs associated with the Australian creditors' schemes process in appropriate cases. A pre-pack scheme would effectively allow the scheme entity and the relevant creditors to negotiate a creditors' scheme prior to any Court application and then present it to the Court for approval on a fast-tracked or expedited basis without a convening hearing or scheme meeting being held.

Pre-pack schemes would allow the scheme entity to dispense with both the first Court hearing to convene a meeting of creditors and the creditors' meeting itself, thereby truncating the normal creditors' scheme process. The Court would have the power to approve a pre-pack creditors' scheme if adequate disclosure has been made to creditors including (a) notice of the application which provides a statement that contains information concerning the company's property and financial prospects and information on how the proposed scheme will affect the rights of those creditors and such information as is necessary to enable the creditor to make an informed decision whether to approve the proposed scheme, and (b) if it is satisfied that had a meeting of each applicable class of creditors been convened the requisite majorities, being 75% by value and 50% by number voting in favour (in person or by proxy) they would have voted to agree to the scheme in each applicable class of creditors. An automatic stay may not be necessary for pre-pack schemes given their procedural nature.

If the Government wishes to further promote the use of Australian creditors' schemes, consideration should also be given to whether any other facilitative provisions are required to enable a creditors' scheme to deal with (a) beneficial owners of property;[40] (b) landlords in respect of ongoing leases;[41] (c) modifications to

[39] See e.g. *Re Boart Longyear Ltd* (2017) 121 ACSR 328; [2017] NSWSC 567; and *Re Tiger Resources Ltd* (2019) 141 ACSR 203; [2019] FCA 2186.
[40] *Re Lehman Brothers International (Europe) (in admin) (No 2*) [2009] EWCA Civ 1161; [2010] BCC 272.
[41] See, e.g., ss 444D(3) and 444F(4), and *Re Instant Cash Loans* [2019] EWHC 2795 (Ch).

enterprise bargaining agreements (which currently require approval by the Fair Work Commission) or modifications to the priority of employee entitlements different from those that apply in liquidation.[42]

There may also be potential to expand the operation of s 413 and apply some of its principles to creditors' schemes particularly in relation to the making of ancillary orders.[43]

Question 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?

We consider that the Court's inherent fairness discretion in the approval of schemes is an appropriate safeguard on potential impacts on various persons and programs who may be affected by creditors' schemes, which would allow the Court to refuse to approve a scheme on various grounds including that it is contrary to public policy.[44]

If a creditors' scheme is promoted and ultimately fails, any erosion of the circulating assets available to meet the priority claims of employees (and the Commonwealth in relation to its entitlement to be subrogated to their claims under the Fair Entitlements Guarantee (**FEG**) scheme) will have consequences for both employees and the FEG scheme. This weighs in favour of careful consideration of the preconditions to access the moratorium.

As noted in our responses to Questions 1 and 5 above, we consider that holistic analysis should be completed which considers potential impacts including whether additional protections are required for directors under s 588FGA and the director penalty regimes under the taxation legislation, and unsecured creditors in relation to the current unfair preference regime under ss 588FA and 588FE.

One key impact to consider is the cross-border implications and in particular whether Australian creditors' schemes will be recognised and implemented in foreign jurisdictions where dissenting creditors may seek to enforce their claims. Australian creditors' schemes can bind creditors including foreign creditors even if the debt or claim arises under or is governed by foreign laws. First, the Court has jurisdiction under s 411 to vary such rights because that section is a law relating to insolvency of corporations that will govern the rights, obligations and property of the insolvent debtor wherever situated.[45] Second, given Australia has adopted the UNCITRAL Model Law on Cross-Border Insolvency Australian creditors' schemes in relation to debtors whose centre of main interests is Australia are capable of being recognised as foreign main proceedings by the Courts of key international financial jurisdictions such the United States, United Kingdom[46] and Singapore, and also other jurisdictions which have similarly enacted UNCITRAL Model Law on Cross-Border Insolvency.[47] Where the foreign representative of a scheme entity obtains recognition of an Australian creditors' scheme as a foreign main proceeding, restraining orders made under s 411(16) as well as scheme discharges and variations of foreign law governed debt are capable of being enforced by the Courts in such jurisdictions.[48] There is no reason in principle why any enhancements to Australian creditors' schemes discussed above would not also be capable of enforcement in such jurisdictions where they already have similar processes in place under their local laws.

Further, we consider that amendments to the ASX Listing Rules should be considered so that a creditors' scheme proposed by ASX listed entity to avoid liquidation under which it is proposed to convert debt to equity can proceed without obtaining shareholder approval in general meeting in circumstances where there is no residual equity value in the company because value breaks in the debt. This conclusion could be addressed in the independent expert's report required for the creditors' schemes, and that conclusion would often be reached where the company's only viable alternative to the creditors' scheme is insolvency

[42] See, e.g., s 444DA and Division 4 of the *Fair Work Act 2009* (Cth).
[43] The power conferred by s 413 enables the Court to make various orders as set out in s 413(1)(a)-(g). The power under s 413(1)(g) is a general power with respect to matters "incidental, consequential or supplemental as are necessary to ensure that the reconstruction or amalgamation is fully and effectively carried out".
[44] See e.g. *In the matter of Ovato Print Pty Ltd* [2020] NSWSC 1882 at [51].
[45] *In the matter of BIS Finance Pty Limited; In the matter of Artsonig Pty Limited* [2017] NSWSC 1713 at [37]; *Re Bulong Nickel Pty Ltd* (2002) 26 WAR 466; [2002] WASC 226 at [13]-[15]; *Re Glencore Nickel Pty Ltd* (2003) 44 ACSR 210; [2003] WASC 18 at [39].
[46] Under English law a foreign insolvency proceeding cannot discharge English law governed debt: *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399; see also *Re Tiger Resources Ltd (*2019) 141 ACSR 203; [2019] FCA 2186.
[47] It is likely that Australian creditors' schemes for the purpose of avoiding insolvency would be a foreign proceeding under the UNCITRAL Model Law on Cross-Border Insolvency in jurisdictions which have enacted it: see e.g. *In the matters of Boart Longyear Limited* [2021] NSWSC 982 at [55]; *Re Boart Longyear Ltd* (2017) 318 FLR 226; [2017] NSWSC 537 at [18]; and *In the matter of BIS Finance Pty Limited; In the matter of Artsonig Pty Limited* [2017] NSWSC 1713 at [46].
[48] See e.g. *Re Boart Longyear Ltd* (2017) 121 ACSR 328; [2017] NSWSC 567; and *Re Emeco Holdings Ltd* (unreported, Federal Court of Australia NSD101/2017, 15 March 2017, Foster J).

filings.[49] It is currently necessary under the ASX Listing Rules to obtain an independent expert's report for the shareholder resolutions to be put to a general meeting.[50] The requirement that an ASX listed entity obtain shareholder approval where a creditors' scheme is proposed for the purpose of avoiding formal insolvency gives shareholders whose equity essentially has nil value a right of veto over a creditors' scheme involving a debt for equity conversion. In our view it is anomalous that shareholder approval should be required after creditors have in effect taken control of the entity's affairs on account of its insolvency or near insolvency.[51]

In summary, we consider that the matters we have suggested above would improve the utility and effectiveness of Australian creditors' schemes including to implement cross-border restructurings affecting creditors in key international jurisdictions and therefore warrant further consideration by the Government. We would suggest these matters warrant meaningful engagement between the Government and interested parties by way of further consultation with Treasury or through a Parliamentary inquiry prior to any draft legislation being released.

Please do not hesitate to contact us if you would like to discuss any of the above matters.

Yours faithfully
MinterEllison

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[49] See e.g. *First Pacific Advisors LLC v Boart Longyear Ltd* (2017) 320 FLR 78; [2017] NSWCA 116 at [82]-[86].
[50] See ASX Listing Rule 7.1 which requires shareholder approval if more than 15% of the existing capital will be issued under a creditors' scheme and ASX Listing Rule 10.11 requires shareholder approval, amongst other things, where securities are to be issued to a related party or to a party who held substantial equity within the prior 6 months (more than 30%).
[51] See *Westpac Banking Corporation v The Bell Group Ltd (in liq) (No 3)* (2012) 44 WAR 1; [2012] WASCA 157 at [2648].