Helping Companies Restructure by Improving Schemes of Arrangement

TMA Australia Submissions

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TMA Australia

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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:

Term	Definition
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

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	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.

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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]

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[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.

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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.

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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

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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

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	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***

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	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

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	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.

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	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.

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	(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.***

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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.

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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.

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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]

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>.

TMA Australia

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

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[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

[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 sectionº2 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.

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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

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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

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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

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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.

[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.

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(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;

[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.

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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).

[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.

[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.

[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

[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.

TMA Australia

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

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[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'

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[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

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[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.

TMA Australia

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.

[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.

[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

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[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.

[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

[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,

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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.

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[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

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[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].

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> 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

[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%)