Insolvency and restructuring

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2024

Insolvency and restructuring

1. Director's duties – Insolvent Trading

Australia has strict laws to prevent insolvent trading. Company directors must not breach these laws.

Directors (including non-executive directors) have a duty to ensure that a company does not incur a debt if the company is insolvent, or becomes insolvent by incurring the debt.

Failing to prevent insolvent trading may result in the director being personally liable for debts incurred if, at the time the debt is incurred by the company, the director had reasonable grounds for suspecting the company is insolvent, or if incurring the debt will cause the company to become insolvent.

2. Safe harbour

A company in financial difficulty may utilise the 'safe harbour regime'.

The safe harbour regime can give a company certain breathing space to pursue a turnaround or financial restructuring plan. Importantly, the safe harbour regime may also provide directors with protection from personal liability for insolvent trading for debts incurred while a safe harbour plan is being pursued.

The safe harbour protections encourage and support directors who make early, genuine and potentially ongoing attempts to restructure their companies in an effort to avoid formal insolvency; and the associated detrimental impacts on all stakeholders including employees and creditors.

In short, and subject to meeting certain criteria, if directors take appropriate steps such as obtaining expert advice and preparing a turnaround plan that is reasonably likely to lead to a better outcome for the company (and its creditors), than an insolvency appointment, they can protect themselves against liability for insolvent trading.

During such a period, in order to meet their duties to the company, the directors must also have regard to the interests of the company's creditors.

3. Restructuring

Australian law provides processes designed to facilitate the financial restructuring of a company. The most common processes include:

- Schemes of arrangement
- Voluntary administration

Schemes of arrangement

A scheme of arrangement is a process by which a company can undertake a financial restructuring via a court sanctioned compromise or arrangement with certain creditors.

To implement a scheme, creditors are usually divided into classes (based upon creditors having similar rights and common interests), and asked to vote on the proposed scheme. If a majority of creditors in each class vote in favour of the scheme, and the court subsequently sanctions the scheme, the compromise or arrangement between the company and its creditors takes effect.

Schemes of arrangement are often used to restructure debt of large companies, or groups of companies.

Voluntary administration

Voluntary administration is a statutory 'out of court' process that can be used to restructure a company, and to preserve the underlying business.

Administration can be initiated a number of ways, the most common of which, is for the directors to pass a resolution to the effect that the company is, or is about to become, insolvent. Alternatively, a secured creditor who holds security over all, or substantially all, of the assets of the company may appoint an administrator.

Once appointed, the administrator (an independent insolvency professional) takes over control of the company from the directors, and must conduct the administration in a way that:

- maximises the chances of the company continuing under a deed of company arrangement (also known as a DOCA); or
- provides a better return to creditors (and possibly shareholders) than if there was an immediate liquidation.

Importantly, administration provides companies that are in severe financial difficulty, or insolvent, with a chance to restructure their financial affairs, or to sell their business as a going concern, and to provide a return to creditors, usually via a Deed of Company Arrangement (DOCA). In order to facilitate this, a key feature of the administration process are statutory moratoriums that protect the company from action by creditors, and the termination of contracts by key suppliers because of the administration.

The outcome (and conclusion) of an administration is determined by its creditors at a meeting convened for that purpose. At that meeting, creditors will have the option of voting for one of two alternatives as follows:

- If one is proposed, a DOCA
- If no DOCA is proposed, and the company is insolvent, liquidation

The administration process is the most widely used method for the restructuring of distressed companies in Australia. It can be utilised for small, medium and large companies alike.

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