Judicial Insolvency Network Conference Singapore October 2016

Several issues in insolvency law reform – the Australian perspective

Justice Ashley Black

Supreme Court of New South Wales

Issues in cross-border insolvency

I should first say something as to the general structure of the insolvency regime in Australian law. Insolvency in respect of companies is dealt with in the *Corporations Act* 2001 (Cth), which is legislation passed by the Commonwealth Parliament, and both the Federal Court of Australia and the Supreme Courts of each of the States and Territories have jurisdiction as to matters arising under that Act.[1]

There is little to be said, from an Australian perspective, about law reform in relation to cross-border insolvency, since the present regime appears to be working reasonably well. Cross-border insolvency is primarily addressed in Australia by the *Cross-Border Insolvency Act* 2008 (Cth) which gives effect to the Model Law on Cross-Border Insolvency adopted by the United Nations Commission on International Trade Law (1997) and commenced operation in Australia on 1 July 2008.[2] Both the Federal Court of Australia and the Supreme Courts of the Australian States and Territories have jurisdiction to recognise foreign proceedings and cooperate with foreign courts in relation to corporate insolvency proceedings under the Model Law.[3]

Effectiveness of article 17 of the Model Law

The provision for recognition of foreign proceedings under article 17 of the Model Law, either as foreign main proceedings or foreign non-main proceedings, generally seems to operate successfully. Australian courts have determined many applications for recognition of foreign proceedings under article 17 of the Model Law, as foreign main proceedings or foreign non-main proceedings, which are generally relatively uncontroversial and successful.[4] In this area, Australian courts have engaged with more

---

[1] Insolvency of natural persons is dealt with in the *Bankruptcy Act* 1966 (Cth) and the Federal Court of Australia and Federal Circuit Court have, with limited exceptions, exclusive jurisdiction.

[2] Sections 2 and 6 of the *Cross-Border Insolvency Act* 2008 (Cth). See generally J Martin, "Cross-Border Insolvency and the Common Law" in KE Lindgren (ed), *International Commercial Litigation and Dispute Resolution*", 2010, pp 213-223; S Maiden, "A comparative analysis of the use of the UNCITRAL model law on cross-border insolvency in Australia, Great Britain and the United States" (2010) 18 *Insolv LJ* 63; S Atkins & R Mason, "Australia" in LC Ho (ed), *Cross-Border Insolvency: A Commentary on the UNCITRAL Model Law*, 3rd ed, 2012, pp15-53.

[3] Section 10 of the *Cross-Border Insolvency Act* 2008 (Cth).

[4] *Hur (in his capacity as foreign representative of Samsun Logix Corporation) v Samsun Logix Corporation* [2009] FCA 372 (recognition of South Korean receivership); *Tucker, in the matter of Aero Inventory (UK) Ltd v Aero Inventory (UK) Ltd (No 2)* (2009) 77 ACSR 510; [2009] FCA 1481 (recognition of UK voluntary administration); *Katayama v Japan Airlines Corporation* (2010) 79 ACSR 286; [2010] FCA 794 (recognition of trusteeship for corporate reorganisation); *Akers (as joint foreign representative) v Saad Investments Co Ltd (in official liquidation)* [2010] FCA 1221 (recognition of liquidation in Cayman Islands); *Re Chow Cho*

complex questions as to which different views have been taken elsewhere, and taken the view that article 16.3 of the Model Law[5] allows the court to dispense with formal proof that the centre of main interests ("COMI") is situated where the debtor's registered office is situated, but leaves the contrary finding open on the evidence[6]; and whether the COMI is to be determined when the foreign proceedings are commenced in the foreign jurisdiction, or when the application for recognition is filed with the Australian Court.[7]

Effect of recognition of foreign main proceeding

Article 20 of the Model Law, as applied by the *Cross-Border Insolvency Act* in Australia, deals with the legal effect of the recognition of a foreign main proceeding. Article 20(1) provides that, if the court recognises a foreign main proceeding, then (1) the commencement or continuation of individual actions or individual proceedings concerning the debtor's assets, rights, obligations or liabilities is stayed; (2) execution against the debtor's assets is stayed; and (3) the right to transfer, encumber or otherwise dispose of the debtor's assets is suspended. That effect arises by operation of law on recognition of the foreign main proceeding, not by any order of the court. The extent of that effect may be modified by the laws referred to in article 20(2) which preserve the operation of local insolvency laws, relevantly Chapter 5 of the *Corporations Act* with specified exclusions.

The most significant Australian decision considering these provisions is *Akers (as joint representative of Saad Investments Company Ltd) (in official liquidation) v Deputy Commissioner of Taxation* (2014) 311 ALR 167; [2014] FCAFC 57 (special leave to appeal declined by the High Court of Australia [2014] HCA Trans 231), where the Full Court of the Federal Court there limited a stay, arising from the recognition of a Cayman Islands liquidation as a foreign main proceeding, to permit the Deputy Commissioner of Taxation to take enforcement action against the company's Australian assets to the extent necessary to recover a pro rata distribution calculated against all of the company's assets. There has been some academic interest in the extent to which that decision is a

---

Poon (Private Ltd) [2011] NSWSC 300 (recognition of Singapore liquidation)*; Lawrence v Northern Crest Investments Ltd (in liq)* [2011] FCA 672 (recognition of New Zealand liquidation); *Sheahan v Ex Ced Foods* [2011] FCA 692 (recognition of New Zealand liquidation); *Raithatha v Ariel Industries PLC* (2012) 212 FCR 139; 303 ALR 433; [2012] FCA 1526 (recognition of a proceeding in the United Kingdom for a creditors' voluntary winding up as a foreign main proceeding); *Asafuji (in his capacity as Foreign Representative of Sanko Steamship Co Ltd) v Sanko Steamship Co Ltd (No 2)* [2012] FCA 1314 (recognition of a Japanese reorganisation proceeding as a foreign main proceeding); *Crumpler v Global Tradewaves (in liq)* [2013] FCA 1127 (recognition of a foreign proceeding in the British Virgin Islands as a foreign main proceeding and orders for a person resident in Sydney to be summoned for examination); *Yakushiji v Daiichi Chuo Kisen Kaisha Star Bulk Carrier Co* [2015] FCA 1170 (recognition of Japanese civil rehabilitation proceeding as foreign main proceeding); *Kim v SW Shipping Co Ltd* (2016) 113 ACSR 260; [2016] FCA 428 (recognition of South Korean rehabilitation proceedings as foreign main proceeding).

[5] Article 16(3) provides that, in the absence of proof to the contrary, the debtor's registered office or habitual residence, in the case of an individual, is presumed to be the debtor's COMI.

[6] *Akers (as joint foreign representative) v Saad Investments Co Ltd (in official liquidation)* (2010) 190 FCR 285; (2010) 276 ALR 508; [2010] FCA 1221. That view is consistent with that taken in *Re Eurofood IFSC Limited* [2006] Ch 508 at [33]-[35] and *Re Stanford International Bank Ltd* [2011] Ch 33; [2010] EWCA Civ 137, although some US decisions take a different approach.

[7] *Kapila v Edelsten* (2014) 320 ALR 506; [2014] FCA 1112 at [46].

qualification to universalism, or to modified universalism. However, the result in that case seems appropriate on its facts, where the Deputy Commissioner of Taxation would otherwise have had access only to one fund of the company's assets, in Australia, and the other creditors would have access to more than one fund, in both the Cayman Islands and Australia.

Grant of other relief

Article 21(1) of the Model Law provides that, on recognition of a main or non-main foreign proceeding, and where necessary to protect the debtor's assets or creditors' interests, the court may grant any appropriate relief including entrusting the administration or realisation of all or part of the debtor's assets located in the state to the foreign representative or another person designated by the court and granting additional relief that may be available to an administrator or liquidator under Australian law.

As Segal J notes in his paper, in *Fibria Celulose SA v Pan Ocean Co Ltd* [2014] EWHC 2124 (Ch), Morgan J held that article 21 of the Model Law, as applied in the United Kingdom, did not authorise the grant of relief that was not available in a domestic insolvency to a foreign insolvency representative. That result is likely to be reinforced in Australia by the Explanatory Memorandum to the Cross-Border Insolvency Bill 2008 (Cth) (paragraph 63) which states that:

> "recognition of a foreign proceeding does not mean extending the effects of the foreign proceeding as they may be prescribed by the law of the foreign State. Instead, recognition of a foreign proceeding entails attaching to the foreign proceeding consequences envisaged by the law of the enacting State [ie Australia]."

Article 21(2) allows the court to entrust the distribution of assets in Australia to a foreign representative if Australian creditors are adequately protected. Article 22 provides that the court must have regard to the interests of creditors, interested persons and the debtor in determining whether to grant or refuse relief under, relevantly, article 21. That article does not itself limit the effect of recognition of foreign main proceedings under article 20 of the Model Law.

Cooperation with foreign courts

Article 25 of the Model Law provides for the court to cooperate to the maximum extent possible with foreign courts or foreign representatives, and article 27 gives examples of several forms of cooperation.[8] Article 27, as adopted in Australia, does not expressly extend to the enforcement of foreign money judgments as a form of cooperation with foreign courts. In *Rubin v Eurofinance SA* [2012] UKSC 46; [2013] 1 AC 236 ("Rubin"), Lord Collins observed (at [143]) that it:

[8] The article refers to appointment of a person or body to act at the court's discretion; communication of information by any means considered appropriate by the court; coordination of the administration and supervision of the debtor's assets and affairs; approval or implementation by courts of agreements concerning the coordination of proceedings; and coordination of concurrent proceedings regarding the same debtor.

> "would be surprising if the Model Law was intended to deal with judgments in insolvency matters by implication. Articles 21, 25 and 27 are concerned with procedural matters. No doubt they should be given a purposive interpretation and should be widely construed in the light of the objects of the Model Law, but there is nothing to suggest that they apply to the recognition and enforcement of foreign judgments against third parties."

There is also Australian case law that such enforcement does not fall within the general concept of cooperation under Article 25.[9] The question whether enforcement of foreign judgments should be (as distinct from is) permitted under those articles raises the wider controversies arising from *Cambridge Gas Transport Corp v Official Committee of Unsecured Creditors of Navigator Holdings plc* [2006] UKPC 26; [2007] 1 AC 508 ("Cambridge Gas") and *Rubin*.

In his paper, Segal J raises the question whether there is a need to reverse *Rubin*, where the UK Supreme Court held that the principle of modified universalism did not allow the Court to enforce a judgment in personam against defendants in bankruptcy proceedings in New York, where the defendants were not present in that jurisdiction and had not submitted to it. Australian courts have not yet addressed that decision in any extended way. In *Quarter Enterprises Pty Ltd v Allardyce Lumber Company Ltd* [2014] NSWCA 3; (2014) 85 NSWLR 404, in the Court of Appeal of the Supreme Court of New South Wales, Bathurst CJ referred to *Rubin* for the proposition that the question whether a foreign court has jurisdiction over a person will be determined by the common law of Australia, and also for the observation of Lord Collins that the law relating to the enforcement of foreign judgments has not in recent times been developed by judge-made law. In *Akers (as joint representative of Saad Investments Company Ltd) (in official liquidation) v Deputy Commissioner of Taxation* above, in the Full Court of the Federal Court, Allsop CJ distinguished the question of enforcement of a foreign default judgment, addressed in *Rubin*, from the question whether acts done in relation to a foreign winding up were sufficient to prevent relief in Australia, concerning assets in Australia, under the Model Law.

It is perhaps unlikely that any Australian court below the High Court of Australia could adopt the broader approach of Lord Hoffmann in *Cambridge Gas* over the approach in *Rubin*. It may also be unlikely that Australia would move to statutory reform in this area, other than in the context of some wider international movement toward reform.

Other policy exclusions

Several other policy choices were made in respect of exclusions from and limits to the Model Law, as applied in Australia, which are not presently controversial in Australia. The regulations made under the *Cross-Border Insolvency Act* exclude deposit-taking institutions and insurance companies from the application of the Model Law. A local jurisdiction plainly has a particular interest in those entities, notwithstanding the impact of globalisation of financial services.

[9] *Re Chow Cho Poon (Private) Ltd* (2011) 80 NSWLR 507; [2011] NSWSC 300.

Discharge of liabilities governed by the law of the jurisdiction

Segal J's paper also refers to the question of the discharge of liabilities governed by the law of the jurisdiction, arising from the decision in *Gibbs & Sons v Societe Industrielle et Commerciale de Metaux* [1886] All ER Rep 804 and its recent application in *Global Distressed Alpha Fund 1 LP v PT Bakrie Investindo* [2011] 1 WLR 2038 ("*Global Distressed Alpha Fund*") and to the implication of these decisions that English courts will not recognise a Chapter 11 plan of reorganisation which discharges debts governed by English law.

In *Gibbs*, Lord Esher MR (at 807) observed that a discharge, by reason of a judicial liquidation in France, of a French company's liability in damages for breach of a contract governed by English law was irrelevant to a claim in England under that contract, because French law was "not the law of this country to which the contract belongs, nor is it one by which the contracting parties have agreed to be bound." Lindley and Lopes LLJ took the same view. That principle was subsequently applied in *New Zealand Loan and Mercantile Agency Co Ltd v Morrison* [1898] AC 349 and *National Bank of Greece and Athens SA v Metliss* [1958] AC 509, and by the Privy Council in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147.

That decision was again followed in *Global Distressed Alpha Fund,* which concerned a claim under a guarantee given by the defendant, governed by English law, of a liability under promissory notes. A debt reorganisation plan ratified by an Indonesian court extinguished the debt owed under the promissory notes and the liability under the guarantee, as a matter of Indonesian law, and the defendant contended that the Court should recognise the Indonesian proceeding and treat the discharge of the guarantee as effective. Teare J recognised criticism of the reasoning in *Gibbs*, including Professor Fletcher's observation that it was "Anglocentric reasoning which should be consigned to history". However, Teare J followed *Gibbs*, on the basis that he was bound to do so as a judge sitting at first instance, although he recognised that giving effect to the Indonesian composition plan would have assisted the Indonesian Court to ensure that all of the defendant's assets were distributed to creditors under a single system of distribution, and would have given effect to the principle of modified universalism. In the result, the discharge of the guarantee under the bankruptcy law of Indonesia was not effective in England where Indonesian law was not the governing law of the contract. In *Erste Group Bank AG, London Branch v JSC 'VMZ Red October'* [2015] EWCA Civ 379 at [76], the Court of Appeal noted that *Gibbs* and the cases that followed it did not address the position where a creditor had actively participated in a foreign insolvency and sought to uphold the validity of its contractual rights in that insolvency.

The decision in *Gibbs* has only once been referred to, without detailed consideration, by an Australian court.[10] An Australian court might well take the same approach as *Gibbs* and *Global Distressed Alpha Fund* and it may again be unlikely that there would be legislative reform in the absence of international movement.

[10] *Bond Media Ltd v John Fairfax Group Pty Ltd* (1988) 14 ACLR 701.

Other avenues for cross-border cooperation in Australia

In parallel to the Model Law, Part 5.6 Div 9 of the *Corporations Act* provides for cooperation between Australian and foreign courts in external administration matters, which include, broadly, a winding up outside Australia of a body corporate or the insolvency of a body corporate. Section 581(2) of the *Corporations Act* requires the Federal Court of Australia and the State and Territory Supreme Courts to act in aid of, and be auxiliary to, courts of prescribed countries that have jurisdiction in external administration matters. The prescribed countries include, inter alia, Jersey, Canada, the Republic of Singapore, the United Kingdom and the United States of America. That section also permits, but does not require the Federal Court of Australia and the State and Territory Supreme Courts to act in aid of, and be auxiliary to, the courts of other countries that have jurisdiction in external administration matters. Section 581(3) provides that, where the Court receives a letter of request from a court of a country other than Australia, it may exercise such powers as it could exercise if the matter had arisen in its own jurisdiction. There is authority that that section requires an Australian court to consider what aid should be given to a court of a prescribed country, but does not require the Australian court to decline to make a winding up order in respect of a registered foreign company (which had its principal place of business in Australia and held shares in another company which had Australian assets) merely because that company had commenced Chapter 11 proceedings in the United States.[11]

Sections 580 and 581 of the *Corporations Act* have some similarity with s 426 of the *Insolvency Act* 1986 (UK); however, they do not include the provision in s 426 of the *Insolvency Act* authorising the application of foreign insolvency law; and s 581 is wider than s 426 of the *Insolvency Act* since it permits an Australian court to act, for example, on the application of an overseas liquidator without having received any request from the overseas court.[12] There has been some academic criticism of the overlap between s 581 of the *Corporations Act* and the Model Law[13], but there appears to be little practical concern in the courts or the profession with that overlap.

Part 5.7 of the *Corporations Act* also allows a foreign company that is registered in Australia or carries on business in Australia to be wound up in Australia, even if it is being or was wound up, dissolved, deregistered or ceased to exist under the laws of the place where it is incorporated. Where a registered foreign company is wound up in its place of origin, a liquidator appointed by an Australian court to that registered foreign company, must, unless the court otherwise orders, recover and realise that foreign company's property in Australia and pay the net amount recovered to the liquidator of the foreign company in its place of origin.[14]

[11] *Legend International Holdings Inc (in liq) v Indian Farmers Fertiliser Cooperative Ltd* [2016] VSCA 151.
[12] *Re Chow Cho Poon (Private) Ltd* above; G McCormack and A Hargovan, "Australia and the International Insolvency Paradigm" (2015) 37 *Sydney L Rev* 389 at 398–399.
[13] McCormack and Hargovan, note 12 above.
[14] *Corporations Act* s 601CL(15).

Debate about Chapter 11 in Australia

I will otherwise focus on three current controversies in domestic insolvency law. The first is an issue as to the relevance of "Chapter 11" style procedures to Australia; the second relates to insolvent trading liability of directors under Australian law; and the third relates to liquidators' remuneration. At least two of those controversies, have wider international application. Singapore, like Australia, has been considering debtor in possession models, reflecting Chapter 11 of the *Bankruptcy Code* (US), although with a different result to the Australian reviews. The United Kingdom, Singapore and Australia have all been struggling with questions of determining appropriate remuneration for insolvency practitioners, and how to address the risk that their fees may exhaust or substantially erode an insolvent estate.

The last substantial review of Australia's insolvency and reorganisation laws occurred in 1988, by the Australian Law Reform Commission's General Insolvency Inquiry (Harmer Report). A "voluntary administration" regime was introduced in Part 5.3A of the *Corporations Act* following the recommendations of the Harmer Report. Previous assessments of the voluntary administration regime in Australia have found it to be generally effective.[15] However, there is some evidence that there is a relatively low survival rate for companies that enter the voluntary administration regime, and the company's business often does not trade on and the average return to unsecured creditors is low. This may reflect the fact that that regime is used by many smaller entities which are in impossible financial positions by the time they enter voluntary administration.[16]

The structure of the voluntary administration regime provides for the appointment of an administrator by the company's board, or by a secured creditor holding security over the whole or substantially the whole of the company's assets, and does not require shareholder, creditor or court approval. An administrator takes control of the company's management and is required to call a first meeting of creditors within a short time, and a second meeting of creditors which determines the company's future within a period of about a month, although the court has power to extend that time period on application.

During the period of the administration, the administrator is required to investigate the company's financial position and circumstances, although the extent of the investigation is usually limited by the relatively short time available for it, and form an opinion as to whether the return of the company to the control of its management, liquidation or any

[15] A report of the Corporations and Markets Advisory Committee, *Rehabilitating large and complex enterprises in financial difficulties* (2004) observed that the regime was "fundamentally sound" and the Parliamentary Joint Committee on Corporations and Financial Services observed in its report, *Corporate Insolvency Laws: A Stocktake* (2004) that the regime provided a "reasonable balance between liquidation and reorganisation".

[16] J Routledge and D Morrison, "Voluntary administration: Patterns of corporate decline" (2009) 27 *C&SLJ* 95; A Herzberg et al, "Does the voluntary administration scheme satisfy its legislative objectives? An exploratory analysis" (2010) 18 *Insolv LJ* 181; M Welland, *A Sample Review of Deeds of Company Arrangement under Part 5.3A of the Corporations Act* (2014); J Martin, "Insolvency Law Reform – Too little but it's not too late", Paper presented at the Corporations Law Conference of the Law Council of Australia and the Federal Court of Australia, 26 August 2016.

proposal for a deed of company arrangement (which may, for example, compromise creditors' claims) is in creditors' interests and make a recommendation to creditors in that respect at a second meeting of creditors. At the second meeting of creditors, creditors vote whether to return the company to the control of its management, execute a deed of company arrangement, or transition the company into a creditors' voluntary winding up, in which the administrator becomes the liquidator. If a deed of company arrangement is executed, the administrator will generally become the deed administrator. A sale of a company's assets or business could be achieved under the terms of a deed of company arrangement. However, there are difficulties in implementing "pre-pack" arrangements in Australian voluntary administrations, including by reason of independence requirements applicable to voluntary administrators, which would likely prevent the appointment of a voluntary administrator who had been involved in negotiation of a sale of assets prior to the appointment.

A moratorium during the administration prevents enforcement of creditors' claims against the company and claims against guarantees given by its officers. Unlike the position in several other jurisdictions, including the United States, there has been no prohibition on ipso facto clauses, which provide that the appointment of an insolvency administrator automatically terminates a contract, in corporate insolvencies.[17] This has been a real obstacle to successful restructurings. The Australian government has proposed introducing such a prohibition, and that proposal seems to have strong industry support.

Schemes of arrangement are used relatively rarely in insolvent restructurings in Australia, largely because of the success of the voluntary administration regime. However, a scheme is necessary where it is sought to obtain wider releases that extend beyond a company and its creditors to, for example, extinguish creditors' claims against third parties.[18]

There has been a continuing debate as to whether Australia should introduce a "debtor in possession" concept, allowing a debtor company's management to remain in control of the company's business during a restructuring, analogous to Chapter 11 of the US Bankruptcy Code.[19] A report of a Senate Committee dealing with the performance of Australia's corporate regulator, the Australian Securities and Investments Commission ("ASIC") (June 2014) recommended (recommendation 61) that:

> "[T]he Government commission a review of Australia's corporate insolvency laws to consider amendments intended to encourage and facilitate corporate turnarounds. The review should

---

[17] By contrast, ipso facto clauses are prohibited in individual insolvencies under s 301 of the *Bankruptcy Act* 1966 (Cth).

[18] *City of Swan v Lehman Brothers Australia Pty Ltd* (2009) 179 FCR 243; 74 ACSR 191; [2009] FCAFC 130, aff'd *Lehman Bros Holdings Inc v City of Swan* [2010] 265 ALR 1; [2010] HCA 11; *Re Opes Prime Stockbroking Ltd* (2009) 179 FCR 20; 258 ALR 362; J Harris, "Adjusting creditor rights against third parties during debt restructuring" (2011) 19 *Insolv LJ* 22.

[19] Earlier inquiries into these issues included reports of the Parliamentary Joint Committee on Corporations and Financial Services, *Corporate Insolvency Laws: A Stocktake* (June 2004) and of the Corporations and Markets Advisory Committee, *Rehabilitating Large and Complex Enterprises in Financial Difficulties* (October 2004).

> consider features of the chapter 11 regime in place in the United States of America that could be adopted in Australia."

On the other hand, the Interim Report of the Financial System Inquiry (July 2014) (which related to a wider review of Australia's financial system) noted that the introduction of Chapter 11 would be costly and "could leave control in the hands of those who are often the cause of a company's financial distress" and that "[a]dopting such a regime would also create more uncertainty for creditors by limiting their rights". The Final Report of the Financial System Inquiry (November 2014) expressed the view that there was little evidence that the Australian regime caused otherwise viable businesses to fail, although elements of the Chapter 11 regime merited consideration, and recommended (recommendation 36) that the Government consult as to amendments to the external administration regime to provide additional flexibility to businesses in financial difficulty. None of these inquiries have supported a full implementation of a Chapter 11 regime in Australia.[20]

The case for a debtor in possession model includes that management may be reluctant to surrender control of a company to an independent administrator, even when it is in financial difficulty, and that management will obviously have knowledge of the company's business and financial affairs. Concerns as to Chapter 11 expressed in Australia include the cost of the court's supervisory function under Chapter 11. In a voluntary administration regime, management decisions are made by the administrator in the ordinary course, and an application will only be made to the court if the administrator seeks authority for an act that would otherwise not be permitted by the voluntary administration regime (which the court has wide power to allow under s 447A of the *Corporations Act*) or requires direction, generally as to a legal issue rather than a commercial issue. There is also concern that Australian creditors would not accept that a company that has reached a position of likely insolvency should remain in the hands of existing management.

I deal below with recent proposals to facilitate informal, management driven, restructurings under Australian law, by reducing the extent of liability for insolvent trading, which are a small step toward restructurings under management control.

Restructuring of smaller companies

In its 2014 discussion paper, *A Platform for Recovery 2014: Dealing with corporate financial distress in Australia* (October 2014), the Australian Restructuring Insolvency and Turnaround Association ("ARITA") raised the question whether it would be desirable to introduce a separate restructuring regime for "micro companies", which ARITA defined as companies with liabilities of less than $250,000. ARITA noted that 43% of Australian

[20] Other recent reviews include a discussion paper published by an industry body, the Australian Restructuring Insolvency and Turnaround Association, *A Platform for Recovery 2014: Dealing with corporate financial distress in Australia* (October 2014) and a report of the Productivity Commission, *Business Set-Up, Transfer and Closure* (2015). For comment, see L Griggs, "Voluntary administration and Chapter 11 of the Bankruptcy Code (US)" (1994) 2 *Insolv LJ* 93; J Harris, "Restructuring Nirvana? Chapter 11 Bankruptcy and Australian Insolvency Reform" (2015) 16 *Insolvency Law Bulletin* 42; A Terzic, "Turning to Chapter 11 to foster corporate rescue in Australia" (2016) 24 *Insolv LJ* 5.

insolvencies have liabilities less than that threshold, and 40% of insolvencies are assetless at the time of insolvency, so that a liquidator will generally only be funded for investigations if ASIC provides funding from the Assetless Administration Fund. ARITA proposed that smaller companies could be permitted to enter a binding agreement with creditors, analogous to agreements available to individual debtors under s 185C of the *Bankruptcy Act* 1966 (Cth), and that a streamlined liquidation regime also apply to such companies. The Australian Government has not adopted those proposals.

Safe harbours from insolvent trading

Australia presently has an onerous insolvent trading regime, by international standards, which, broadly, imposes liability on a director in respect of debts incurred by a company that is insolvent (in the sense of being unable to pay its debts as and when they fell due) if there were (objectively) reasonable grounds for suspecting the company's insolvency. Although there are several defences to such liability, it does not depend on a wrongful intention.

In its Proposals Paper, *Improving Bankruptcy and Insolvency Laws* (April 2016), the Commonwealth Government raises the possibility of introducing two forms of safe harbor to limit the risk of personal liability for directors for insolvent trading, where a director is involved in restructuring efforts. The Proposals Paper identifies the rationale for the reform as that it would strengthen Australia's "start-up culture" by moving from a regime that penalises directors and stigmatises failure, so as to encourage entrepreneurship and assist start-ups in attracting experienced and talented board members. The proposed reforms would impact on a larger number of cases dealt with by insolvency practitioners and courts which do not fall within their stated rationale referable to start-up companies.

The first proposed form of safe harbor ("Safe Harbour Model A") would provide a defence where a director has an expectation, based on advice received from an appropriately experienced, qualified and informed restructuring adviser[21], that a company can be returned to solvency within a reasonable period of time and the director is taking reasonable steps to do so. The defence would only apply in respect of liability for insolvent trading and not for all potential breaches of the *Corporations Act*.

An alternative form of safe harbour ("Safe Harbour Model B"), which seems to have wider professional support, would apply to debts incurred as part of reasonable steps to maintain or return a company to solvency within a reasonable period of time, where a person held an honest and reasonable belief that incurring the debt was in the company's best interests and the interests of creditors as a whole and incurring the debt did not materially increase the risk of serious loss to creditors. This alternative does not necessarily involve the retainer of an insolvency practitioner to provide restructuring advice, although expert advice would no doubt assist directors in establishing the existence of an honest and reasonable belief as to the relevant matters.

[21] The restructuring adviser would be excluded from the definition of director so as not to be at risk of being held to be a shadow or de facto director, and would be required to report any misconduct that he or she identified to ASIC. The restructuring adviser would also be protected against third party claims, provided his or her opinion was honestly and reasonably held.

There are plainly arguments that are capable of being put each way in respect of this proposal. On the one hand, the Australian insolvent trading regime is significantly more onerous than comparable regimes in other developed economies[22], and there is a strong case that the insolvent trading regime operates as a significant practical disincentive to informal workout arrangements. The contrary view is that individual creditors, or creditors generally, may be left with the risk that a restructuring proposal fails and they are left without recourse for debts incurred in the course of it.

Issues as to liquidators' remuneration

The question of liquidators' remuneration has again been controversial in recent Australian case law.[23] Australian liquidators prefer to be paid for their services on the basis of time-based remuneration at standard rates. Issues with time-based claims for remuneration of insolvency practitioners have long been identified in the case law.[24]

This issue has also had recent scrutiny in Singapore and the United Kingdom. Issues as to the remuneration of insolvency practitioners were considered in the United Kingdom by a report by the Office of Fair Trading (2010) and a further report by Professor Kempson to the Insolvency Service in 2013, which recognised difficulties in creditors exercising control over such remuneration. The *Insolvency (Amendment) Rules* 2015 (UK), introduced in the United Kingdom with effect from 1 October 2015[25], requires insolvency practitioners who seek to be remunerated on a time-cost basis to provide fee estimates to creditors, giving details of their likely remuneration and expenses, before the basis of their remuneration is determined and, in effect, caps remuneration (but not expenses) at the level of the estimate unless further approval is obtained. That approach broadly corresponds to prospective approval for remuneration, subject to a cap, under Part 15 of the ARITA Code of Professional Practice for Insolvency Practitioners ("ARITA Code"). In Singapore, in *Kao Chai-Chau Linda v Fong Wai Lyn Carolyn* [2015] SGHC 260, Steven Chong J also pointed to similar issues arising in Singaporean insolvency administrations.

Under Australian law, a liquidator is entitled to reasonable remuneration for his or her services and a liquidator seeking such remuneration bears the onus of establishing that the remuneration claimed is fair and reasonable, having regard to factors specified in ss 473(10) and 504(2) of the *Corporations Act*.[26] The ARITA Code includes several

[22] J Harris, "Director Liability for Insolvent Trading: Is the Cure Worse than the Disease" (2009) 23 *AJCL* 266 at 269.

[23] For commentary in respect of judicial review of remuneration generally, see J Dickfos "The Costs and Benefits of Regulating the Market for Corporate Insolvency Practitioner Remuneration" (2016) 25 *International Insolvency Review* 56; S Steele, V Chen and I Ramsay, "An Empirical Study of Australian Judicial Decisions Relating to Insolvency Practitioner Remuneration", forthcoming, 2016.

[24] See, for example, *Mirror Group Newspapers plc v Maxwell (No 2)* [1998] 1 BCLC 638.

[25] For commentary, see D Milman, "Corporate insolvency in 2015: the ever-changing legal landscape" *Co L.N.* 2015, 368, 1-5; S Morgan, "Insolvency office holder remuneration: the practical aspects of fee approval, challenges and independent reviews" (2016) 29(6) *Insolv Int* 87-92.

[26] *Re AAA Financial Intelligence Ltd (in liq) (No 2)* [2014] NSWSC 1270 at [26]; *Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2)* [2016] NSWSC 106 at [32].

principles relevant to the remuneration of insolvency practitioners.[27] Most decisions in both state Supreme Courts and in the Federal Court of Australia apply time costing as at least the starting point for a calculation of remuneration, although those decisions also emphasise the need for proportionality between the cost of the work done and the value of the services provided.[28] However, several recent decisions in the Supreme Court of New South Wales have emphasised the significance of the percentage that a liquidator's remuneration bears to the level of asset realisations achieved, and applied percentages of recoveries where time-based calculations would have led to unreasonable results.[29] One of those decisions is now under appeal. Another possibility is to use percentage of realisations at least as a test of remuneration claims brought by a liquidator on a time-based basis.[30]

There is room for concern about standard hourly rates being applied to both large and small insolvencies. Whichever approach is adopted, there will be cases where the complexity of the issues in an insolvency, or the scarcity of assets, are such that the insolvency practitioner's remuneration for work that is reasonably necessary to address those issues, if charged at his or her ordinary rates, and costs and disbursements, would exhaust or substantially dissipate the assets of the insolvent company, extinguishing or significantly reducing any return to creditors. That difficulty cannot always be resolved by a suggestion that the insolvency practitioner should not undertake that work, because that work may be required by statutory requirements, or because assets may not be recoverable, or a distribution to creditors may not be possible on any reasonable basis, without undertaking that work. Absent a position where insolvency practitioners are bound to accept appointment in smaller or more complex insolvencies, parties would potentially have difficulty in obtaining their consents to such appointments, and courts would have consequential difficulty in making such appointments, if those appointments were generally unprofitable for insolvency practitioners and their firms.

---

[27] Principle 10 provides that a practitioner is entitled to claim remuneration and disbursements in respect of necessary work, properly performed in an administration, and explains those concepts. Principle 11 deals with disclosure of remuneration and the ARITA Code identifies several possible bases of calculation of remuneration, namely time-based charging; prospective fee approval, subject to a cap to a nominated limit; and a fixed fee or a "percentage of a particular factor", usually assets disclosed or assets realised. Principle 12 provides that a practitioner is only entitled to draw remuneration once it is approved and according to the terms of the approval.

[28] *Venetian Nominees Pty Ltd v Conlan* (1998) 20 WAR 96; *Conlan v Adams* (2008) 65 ACSR 521; [2008] WASCA 61; *Thackray v Gunns Plantations Ltd* (2011) 85 ACSR 144; [2011] VSC 380; *Hayes, Re Henry Walker Eltin Group Ltd (in liq) (No 4)* [2015] FCA 656; *Re Traditional Values Management Ltd (in liq) (No 2)* [2015] VSC 126; *Re Hewitt (in his capacity as Special Purpose Liquidator of Traditional Values Management Ltd (in liq) (special purpose liquidator appointed))* [2015] VSC 338; *Templeton v Australian Securities and Investments Commission* (2015) 108 ACSR 545; [2015] FCAFC 137; *Warner, Re GTL Tradeup Pty Ltd (in liq)* (2015) 104 ACSR 633; [2015] FCA 323; *Macks v Maka* [2015] SASC 200; *Re Koori Employment Enterprises Co-Operative Ltd (in liq)* [2016] VSC 245; *Re Smith (in his capacity as former provisional liquidator of Australian Global Capital Pty Ltd (in liq))* [2016] FCA 644.

[29] *Re AAA Financial Intelligence Ltd (in liq) (No 2)* [2014] NSWSC 1270; *Re Hellion Protection Pty Ltd (in liq)* [2014] NSWSC 1299; *Re Gramarkerr Pty Ltd (No 2)* [2014] NSWSC 1405; *Re Independent Contractor Services (Aust) Pty Ltd (in liq) (No 2)* [2016] NSWSC 106; *Re Sakr Nominees Pty Ltd* [2016] NSWSC 709.

[30] *Clout in his capacity as liquidator of Mainz Developments Pty Ltd (in liq)* [2016] NSWSC 1146; *Re Idylic Solutions Pty Ltd atf Super Save Superannuation Fund* [2016] NSWSC 1292.

The *Insolvency Law Reform Act* 2016 (Cth), which is expected to commence partly on 1 March and partly on 1 September 2017, will make modest amendments to the process for remuneration of insolvency practitioners from its commencement, expected to be 1 September 2017 for these changes. Creditors, a committee of inspection or the court will be able to make a remuneration determination and the court will have power to review such a determination.[31] A cap will be required for remuneration that is determined on a time costing basis.[32] There will be provision for appointment of a registered liquidator to review another insolvency practitioner's remuneration and costs or expenses, by resolution of the creditors and, subject to limitations, by one or more creditor(s).[33] That Act will also make other amendments to the *Bankruptcy Act* 1966 (Cth) and the *Corporations Act* to introduce common rules for the registration, regulation and discipline of corporate and personal insolvency practitioners.

[31] Insolvency Practice Schedule (Corporations) Div 60 Subdiv B.
[32] Insolvency Practice Schedule (Corporations) Div 60, s 60-10.
[33] Insolvency Practice Schedule (Corporations) Div 90, s 90-24.