HERBERT SMITH FREEHILLS

WHAT YOU NEED TO KNOW ABOUT CHANGES TO AUSTRALIA'S CORPORATE INSOLVENCY LAWS

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Legal Briefings – By **Alan Mitchell** and **Lisa Filippin**

Changes to Australia's corporate insolvency laws are set to come into effect in 2017 and will result in an increase of powers for creditors in external administrations.

IN BRIEF

- Greater powers afforded to creditors will include the ability to give directions to an external administrator, request the external administrator to convene a meeting or provide them with information or documents, and appoint persons to provide advice to the creditors or the committee of inspection.
- The changes will come into effect on 1 March and 1 September 2017 following the commencement of the *Insolvency Law Reform Act 2016* (Cth) (**ILRA**) and the Insolvency Practice Rules (**Rules**).
- Whilst the ILRA has received royal assent, the Rules are in draft only. The Australian Government (**Government**) is seeking submissions from interested parties on the Rules and associated legislative instruments by 4 November 2016.
- Separately, in April 2016 the Government proposed changes to introduce a safe harbour for directors and to reform the law on *ipso facto* clauses in an insolvency event. The ILRA and the Rules make no provision for those reforms, which are yet to be introduced into parliament.

Given the release of the Rules and associated legislative instruments, it is a timely opportunity to revisit the ILRA and associated reforms. Summarised in this article is:

- an overview of the ILRA and its purposes;
- key provisions of the ILRA that will impact on creditors in particular;
- when these changes will come into effect; and
- what's next for reforms to corporate insolvency laws.

WHAT IS THE ILRA?

The ILRA proposes to make changes to both bankruptcy and corporate insolvency laws, and is structured in the form of schedules. The key part is the Insolvency Practice Schedule (Corporations) (**Schedule**), which is to be inserted as Schedule 2 into the *Corporations Act 2001* (Cth) (**Corporations Act**).

The Schedule has two principle objectives: (i) to regulate persons registered as liquidators, and (ii) to regulate external administrations consistently and to give greater control to creditors. Whilst the first objective largely impacts on registered liquidators and provides for changes around registration, insurance, obligations and disciplinary and other action, the second objective sees the introduction of provisions which impact on the role and powers of creditors in an external administration.[1]

The accompanying Rules are key to understanding how insolvency practitioners and creditors are affected by the changes. The ILRA and the Rules, whilst not making wholesale changes to Australia's corporate insolvency laws, add greater complexity in determining how these provisions apply to a company in external administration.

HOW WILL THESE CHANGES AFFECT CREDITORS?

Set out below are some of the key provisions that affect creditors.

Powers of creditors

The reforms elevate the role of creditors in an external administration by providing them with additional powers. Creditors of a company will be able to:

1. request an external administrator[2] to provide information, reports and documents (explained further below);

2. where the company is in liquidation, direct a liquidator to convene a meeting (either by resolution, in writing in certain circumstances, or through a committee of inspection). The request must be complied with unless it is unreasonable;

3. by resolution or through a committee of inspection give directions to the external administrator;

4. by resolution, appoint a registered liquidator to carry out a review of the remuneration of, or any cost or expense incurred by, the external administrator, with the costs of the review to form part of the expenses of the external administration; and

5. by resolution at a meeting remove an external administrator (other than a provisional liquidator) and appoint another. Notice of the meeting must be given, and the external administrator is able to make a court application seeking reappointment. This is a greater power than is otherwise currently provided for under the Corporations Act, which only provides the power of removal at certain meetings and in certain forms of external administration.

So that creditors are aware of these rights, the external administrator must give information to the creditors about these rights as soon as reasonably practicable, and will ordinarily be given soon after his or her appointment.

Committees of inspection

The ILRA and the Rules make changes so that all creditors' committees in an external administration are known as committees of inspection.

A committee will be able to give directions to the external administrator. An external administrator must have regard to the directions given by the committee, though is not required to comply with them (not doing so will require the external administrator to record his or her reasons for non-compliance).

Committees will also have the power to resolve that one of its member obtain specialist advice in relation to the external administration (though the approval of the external administrator or the court needs to be obtained before expenses of doing so are incurred). This potentially allows a committee to have greater oversight into the role of the external administrator through the engagement of a specialist person to advise it on aspects of the external administration.

Large creditors

Large creditors (being a creditor or group of creditors representing at least 10% in value of the creditors) have a right to appoint a person as a member of a committee of inspection.

The ILRA provides that, where a large creditor appoints a person as a member of a committee of inspection, the creditor must not directly or indirectly become the purchaser of any part of the property of the company. There are three exceptions: (i) where the creditors resolve otherwise; (ii) where the court gives leave to the creditor to purchase the property; or (iii) where another provision of the Corporations Act or another law requires or permits the creditor to purchase the property. Any such transaction entered into in contravention of this provision may be set aside by the court.

Assignment of rights to sue

Section 100-5 of the Schedule allows an external administrator to assign any right to sue that is conferred on him or under by the Corporations Act, prior to which written notice must be given to creditors of the proposed assignment (or, where the action has already commenced, leave of the court will be required). This will include voidable transaction claims and claims for insolvent trading.

Such a provision may see an increase in recovery actions taken in an external administration, particularly in circumstances where a third party is prepared to bear the risk of such actions.

Request for information

Creditors are entitled to request an external administrator to give information, provide a report or produce a document to the creditors, a right currently not provided for in the Corporations Act.

If the external administrator refuses to provide the information, ASIC has the power to direct the external administrator to comply with the request, and the party who made the request may apply to the court for an order that the information be given.

Separate to the above, the Rules also require a liquidator to report to the creditors the likelihood of receiving a dividend before the affairs of the company are fully wound up within 3 months of appointment.

Such provisions are a powerful way of creditors gaining information about the external administration, such as information about creditors and their claims, potential recovery proceedings, whether the external administrator has decided to issue such proceedings, and what dividend if at all the creditors are likely to receive.

What is an unreasonable request or direction?

Generally, the Rules provide that it is not unreasonable for an external administrator to comply with a request or direction if the external administrator, acting in good faith, is of a certain opinion. This includes where the external administration is of the opinion that (i) complying with the request or direction would substantially prejudice the interests of creditors or a third party, which outweighs the benefits of complying; (ii) there is insufficient property available to comply; or (iii) the request or direction is vexatious. The external administrator may, in responding to a request for information, also refuse that request if he or she is of the opinion that the information is privileged, or disclosure of the information would found an action for breach of confidence.

WHEN DOES IT COMMENCE?

Parts of the ILRA and the Rules will commence on 1 March 2017, with the remainder to come into effect on 1 September 2017.

The Rules, associated legislative instruments and Part 3 of Schedule 2 of the ILRA are to be read together to determine when provisions take effect.

Close consideration needs to be given to these instruments, and in particular to determine how ongoing external administrations are impacted. Generally, the old provisions of the Corporations Act will continue to apply to old events and processes that are incomplete. However, many of the provisions that provide greater powers to creditors, including the power to request information and give directions, will apply to both new and ongoing external administrations.

The transition provisions are complicated given the staggered introduction of the ILRA, so stakeholders in an external administration should take care to ensure the proper provisions are being considered.

WHAT ABOUT SAFE HARBOUR AND IPSO FACTO CLAUSES?

Following the Productivity Commission's report in December 2015, some of which made recommendations to reform Australia's insolvency laws, the ILRA has been seen as a missed opportunity to undertake wholesale changes to Australia's insolvency regime.

On 29 April 2016, the Government released its proposals paper, in which it made recommendations for changes which introduced a safe harbour for directors, and changed the operation of *ipso facto* clauses. Submissions closed on 27 May 2016 and the Government received 72 submissions from interested parties, including Herbert Smith Freehills.

To date, no Bill has been introduced which gives effect to these changes. However, the Government has indicated that these reforms are being progressed as part of the Government's National Innovation and Science Agenda, suggesting that such changes remain on the horizon.

ENDNOTES

1. External administration of a company is defined in the Schedule as being a company that is under administration (including under a deed of company administration), or is in liquidation or provisional liquidation. External administration does not include receivership or where a controller has been appointed in relation to the company's property: s5-15 of the Schedule.

2. An external administrator includes a voluntary administrator, deed of company administrator, liquidator and provisional liquidator.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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