

# Insolvency Law

Corporate Insolvency: Update by Oren Bigos



Every day corporate insolvency is in the news. Numerous companies are falling victim to the global financial crisis and the tighter credit conditions. Some are in external administration, while other distressed companies struggle to avoid it.

Directors have to make decisions about whether to continue to trade, thereby risking liability for insolvent trading, or to appoint administrators. Should a business judgment defence be introduced (reflecting the Canadian position), in order to prevent the premature entry into external administration, particularly in large corporations? The federal Treasury's 'Review of Sanctions in Corporate Law' (2007) invited submissions on this topic but no action has been taken yet as a result.

The most drastic form of external administration is winding-up. This is a last resort as it represents the sudden death of the company, with adverse consequences for the directors, creditors, employees, members and customers. Company liquidations have increased rapidly since the financial crisis began.

There are alternatives to winding-up, both informal and formal. Under an informal reconstruction or private work-out, the company and its major creditors negotiate a restructure of debt that allows the company to survive. Recent examples include Centro Properties Group and Babcock & Brown. The recent decision in *The Bell Group Ltd (in liq) v Westpac Banking Corporation (No 9)* [2008] WASC 239 (one of the longest and most expensive civil actions in Australian history) sounds a warning. If the directors and major lenders negotiate a work-out without considering the interests of other creditors, they open themselves to attack. When a company is insolvent or approaching insolvency, the lenders cannot bury their hand in the sand; they are at risk of secondary liability for a breach of the directors' duty to take into account the interests of the company as a whole (including the interests of creditors, which come to the fore).

As for formal rehabilitation, the most common regime is voluntary administration, which may lead to a deed of company arrangement. The law on this topic was streamlined with the passage of the *Corporations Amendment (Insolvency) Act 2007* (Cth), and further procedural improvements may be expected following the publication of the federal government's Corporations and Markets Advisory Committee (CAMAC) report on 'Issues in external administration' (November 2008). A less common rehabilitation regime, requiring court approval, is a creditors' scheme of arrangement. This is currently proposed in order to give effect to the settlement of claims by former clients of Opes Prime.

Another form of external administration of companies is receivership. Secured creditors have become less hesitant in enforcing their securities and exercising their right to appoint a receiver. Recent examples include Allco Finance Group, ABC

Learning Centres and Storm Financial. Secured creditors will be affected by the proposed Personal Property Securities legislation (currently a bill exposure draft), a national system based on Canadian and New Zealand laws set to replace many State and Territory statutes on the topic.

Many of the casualties of the global financial crisis are corporate groups. This complicates matters both for directors and lenders. For example, in *The Bell Group* judgment, the directors came under criticism for considering the interests of the group, rather than those of the individual companies. One reform introduced by the *Corporations Amendment (Insolvency) Act 2007* is the pooling of assets and liabilities among group companies that are wound up.

Some companies affected by the crisis operate internationally. Overseas the financial picture is even more dire than in Australia. Australia adopted the UNCITRAL Model Law on Cross-Border Insolvency by enacting the *Cross-Border Insolvency Act 2008* (Cth). This gives a foreign liquidator (or other insolvency 'representative') the right to apply to an Australian court for recognition of both his or her status and the foreign insolvency proceeding. The consequences of recognition include various moratoria on enforcement in Australia. Recently the liquidator of Betcorp used an overseas equivalent of the legislation (chapter 15 of the *Bankruptcy Code* (US)) to obtain recognition of the Australian winding up in the United States.

In two recent reports, CAMAC considered whether law reform is necessary in the area of proof and ranking of claims. According to 'Long-tail liabilities: The treatment of unascertained future personal injury claims' (May 2008), a court should have the power to order a liquidator to set aside funds for individuals whose personal injury claims against the company have not yet crystallised but will arise at some indefinite future time, eg a person exposed to asbestos fibres that does not yet suffer from asbestosis. 'Shareholder claims against insolvent companies' (December 2008) advocates against a legislative reversal of the High Court's decision in *Sons of Gwalia Ltd v Margaretic* (2007) 231 CLR 160 which enables shareholders who acquired shares as a result of misleading conduct by a company to be treated as unsecured creditors in insolvency.

Part of the role of ASIC, the corporate regulator, is to investigate corporate collapses and take enforcement action against directors and others. In addition, liquidators are frequent litigants in proceedings for the recovery of assets. The lighter stance towards litigation funding taken by the High Court in *Campbell's Cash & Carry Pty Ltd v Fostif Pty Ltd* (2006) 229 CLR 386 may also encourage investors to commence class actions to recover their losses in the aftermath of a corporate collapse.