ARITA
AUSTRALIAN RESTRUCTURING INSOLVENCY & TURNAROUND ASSOCIATION

8 September 2021

The Manager
Market Conduct Division
The Treasury
Langton Crescent
Parkes ACT 2600
Attention: Mr Matthew Bowd

By email: MCDInsolvency@Treasury.gov.au

Dear Sir/Madam

Helping companies restructure by improving schemes of arrangement

Thank you for the opportunity to lodge a submission in response to Treasury's consultation paper on helping companies restructure by improving schemes of arrangement.

As you would be aware, the call for improvements to schemes came from ARITA in 2014 and our policy recommendations were, in outline, adopted by the Productivity Commission in its 2015 Inquiry into Business Set-Up, Transfer and Closures.

We think it is important, at the outset, to note that a schemes of arrangement is a restructuring tool which will be used in very few instances in practice in an insolvency context. This does not diminish the importance of reform, as schemes could well be the most effective tool to save some very large, financially distressed entities. Nevertheless, we would expect schemes to be used just a handful of times in any given year. This aligns with the use of Chapter 11 in the United States where, despite appearances, there are generally less than a few dozen public companies that use that framework in any given year.

We also wish to have it prominently noted that schemes are, generally, substantially more expensive to implement than voluntary administration. Indeed, we are aware of one recent scheme in Australia where fees were in excess of $50 million. This is reflective of the complexity of the companies and corporate groups that are utilising schemes in their present form.

Our final caveat is that feedback from our expert members is that schemes would not have been useful in some of Australia's recent high profile external administrations. In those instances, the power and flexibility of a voluntary administration allowed assets and liabilities to be repositioned across complex corporate groups, creating a viable primary entity and carving off other parts of the group that were dragging the business down. The complexity of schemes is amplified in complex corporate groups.

While ARITA supports the concept of improving schemes of arrangement, we maintain our view that Australia needs a root and branch review of the entire insolvency framework to deliver a more fit for purpose regime to rescue viable businesses and jobs – in the interests of the broader Australian economy – and to appropriately protect creditors.

It would be ideal for such a review to be undertaken independently by the Australian Law Reform Commission (noting that the last independent root and branch insolvency law review was undertaken by the independent Harmer Committee in 1988). This would ensure that Australia has in place an internationally recognised, best practice insolvency and restructuring system capable of acting as a key pillar for innovation, productivity and long-term economic and financial stability and growth. In turn, this would also support Australia's international competitiveness, with the modernisation of insolvency and restructuring processes currently the primary focus of governments in jurisdictions across the globe, from the United Kingdom, the European Union and the United States to Singapore, Hong Kong and other regions in the Asia-Pacific.

Why do schemes need to be improved?

Australia's current scheme of arrangement process is used by companies in both a solvent context (typically as part of a share or asset sale or other capital transaction) and an insolvent context (to effect a restructuring of a distressed company and its underlying debts).

In accordance with the consultation paper, our focus in this submission is on the improvement of the existing process in an insolvency context.

There are a number of reasons why the current scheme of arrangement process needs to be improved:

- The same process is used for both solvent and insolvent restructuring. The needs of these two processes are necessarily very different and this should be recognised by the establishment of a tailored, separate process for financially distressed companies.

- There is no moratorium preceding the commencement of the court process required to enable members and/or creditors to vote on a scheme and for the court to approve a scheme. We acknowledge the limited moratorium that can be ordered by the court at the initial hearing to approve the meetings of classes of creditors (orders of this kind falling within the scope of the court's discretion in s 411(16) of the *Corporations Act 2001* (Cth) (Act)), but this is too late in the process for a financially distressed business. Furthermore, this moratorium is discretionary and does not offer any certainty for a distressed company and creditors alike in being able to progress restructuring negotiations.

- There is no ability to force dissenting classes of creditors to accept any restructuring plan, even if it is a better outcome for creditors overall, that has been accepted by all other classes of creditors and will result in rescuing the company or the business as a going concern.

- There is no oversight by a registered liquidator in the period leading up to a scheme being put to creditors, including during any existing court-ordered moratorium. It is likely that any financially distressed company undertaking steps to offer a scheme to its creditors would be insolvent at that time and the directors would be running the risk of insolvent trading (though in certain circumstances directors may be able to avail themselves of the safe harbour under s 588GA of the Act). Indeed, that is precisely why schemes, as they now operate in an insolvency context, often have a precursor external administration. It would offer greater protection for creditors if a registered liquidator was supervising the process. This would also avoid the additional cost of a precursor external administration.

- There is no protection for new creditors whose debts are incurred in the period leading up to a scheme being put to creditors. A precursor moratorium (with a related payment 'waterfall' or priority regime) could provide this protection, encouraging creditors to support the process.

- There is no ability to obtain new finance with a 'super priority' under the current schemes process. This is a particularly limiting circumstance in practice. To be able to successfully rescue the company or its business – with the required level of working capital in scarce supply during a period of financial distress – new finance may be needed and there ought to be a process to enable and incentivise this.

- Schemes have a valuable benefit of being able to bind secured creditors, owners and lessors that Part 5.3A of the Act does not provide unless the secured creditor, owner or lessor votes in favour of the relevant deed of company arrangement. Yet there are currently also downsides of schemes of arrangement – including the absence of an enforcement moratorium while a scheme is negotiated – which mean that they are not as attractive as the voluntary administration/deed of company arrangement process. Improvement of the current scheme of arrangement process may lead to the more widespread use of schemes going forward in an insolvency context.

- There is currently no protection for employees, other than the final court approval of a scheme. There is a need to ensure that employees retain a measure of protection of their entitlements within the process, although it is not necessary to align with the Part 5.3A process.

International position

Both the United Kingdom and Singapore have implemented reworked schemes and introduced moratoriums recently – the United Kingdom with its new restructuring plan and Part A1 moratorium, which is a standalone external administration process, introduced in June 2020 and Singapore's scheme of arrangement and pre-scheme moratorium introduced in 2017.

In addition, on 20 June 2019, the European Parliament and Council adopted the revised Restructuring Directive (Directive 2019/1023). This requires all EU Member States to implement a 'preventive restructuring framework' for financially distressed companies when there is a likelihood of insolvency by 17 July 2021 (subject to a one-year extension).

A core component of the required preventive restructuring framework is the ability of a distressed company to propose a restructuring plan which includes a cross-class cram-down mechanism so that dissenting classes of creditors who do not vote in favour of the plan can be ordered by the court to be bound. Among other things, the revised Restructuring Directive also requires Member States to:

- Provide for a pre-plan moratorium period to maximise the likelihood of a plan being negotiated while the distressed company is given necessary 'breathing room'.

- Implement mechanisms to ensure interim finance 'reasonably and immediately necessary for the continued operation or survival of the debtor's business or the preservation or enhancement of the value of that business' pending consideration of the plan (even if it is not approved) by creditors is incentivised, for example through a priority regime for moratorium debts incurred in relation to new finance provided to a distressed company. A payment waterfall of this kind is part of the new Part A1 moratorium in the United Kingdom.

The revised Restructuring Directive is in the process of being implemented in EU Member States. For example, in The Netherlands, the so-called 'Dutch Scheme' providing for a new cross-class cram-down restructuring plan and a pre-plan moratorium was adopted by the Dutch Parliament on 26 May 2020.

Having in place an effective, more flexible restructuring process for larger companies in financial distress – of the kind contemplated by the EU framework and the processes that are now in effect in the United Kingdom, Singapore and The Netherlands (with other EU States to shortly follow) – is clearly being seen as a necessary component of an insolvency system that accords with international best practice.

Indeed, the inflexibility of the existing alternatives in Australia, and the more limited prospect of binding dissenting creditors to a viable restructuring plan for larger entities, is a deterrent to a restructuring outcome that may serve the best interests of multiple stakeholders and support a stronger entrepreneurial culture in Australia, as well as function as a key component of economic and financial stability and long-term growth. In the absence of an alternative process, Australia may fall behind other regions as an effective and recognised insolvency and restructuring hub in our region.

What could the new scheme of arrangement process for financially distressed companies look like?

ARITA has considered:

- What needs a reworked schemes process would need to address.
- The position internationally.

- The current restructuring options available in Australia – both under Part 5.3A and Part 5.3B of the Act.
- ARITA's thought leadership paper 'A Platform for Recovery' from 2014.
- The recommendations from the Productivity Commission's Report on 'Business Set-Up, Transfer and Closure' in December 2015.
- Recommendations for change expressed by our members who have undertaken a scheme in its current format.

As a result of this, ARITA has formed a view that **significant change is needed to Australia's current scheme of arrangement process** to make it an effective, modern and flexible option for the restructuring of large to very large financially distressed but viable companies – critical in a time when the pace of global business change and innovation continues to rapidly advance.

On the following page is a diagram which provides an overview of the process we propose.

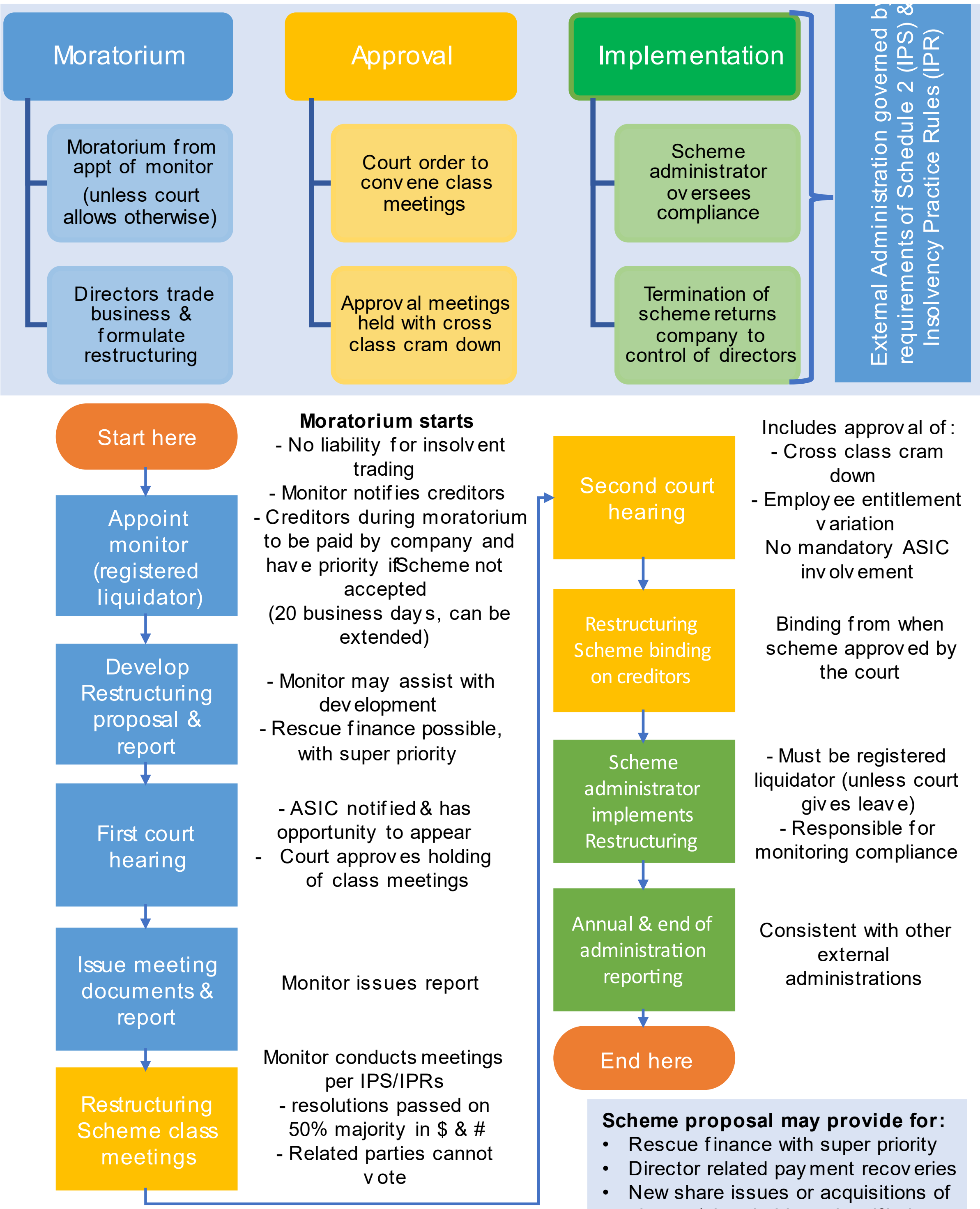
The new process is based on the current scheme of arrangement process (court approval/meeting structure) but with:

- Eligibility confined to companies in financial distress.
- A pre-scheme moratorium.
- Moratorium creditors to be paid during moratorium and priority treatment in the event of liquidation.
- Cross class cramdown.
- Rescue finance with priority.
- Amended voting thresholds.
- Court approval of any arrangement that results in employee entitlements of redundant employees being treated differently to liquidation (if liquidation had occurred at the commencement of the moratorium).
- Inclusion of recoveries from related parties.

Attached at:

- Appendix A is a more detailed discussion of the proposed changes.
- Appendix B is a comparison of the current schemes to the proposed position.

Restructuring Scheme (for financially distressed companies)



Monitor must termination moratorium if in their view the company is unlikely to propose a scheme which has a reasonable prospect of rescuing the company or business as a going concern, or company not paying required debts

Scheme proposal may provide for:

- Rescue finance with super priority
- Director related payment recoveries
- New share issues or acquisitions of shares (shareholders classified as a class)
- Differential treatment of redundant employee entitlements

What to call it?

We acknowledge that there would be some confusion created by having both solvent schemes of arrangement, as they currently exist, and a new scheme of arrangement framework for distressed entities. It would be unhelpful to the process if the latter became known as 'insolvent schemes'. Accordingly, we suggest that they are better and more positively referred to as 'restructuring schemes'.

Who should run it?

The role of monitor (during the moratorium) and scheme administrator (during the restructuring scheme) should be filled by a registered liquidator unless the court consents to the appointment of someone else. This is consistent with the current position in relation to who can act as a scheme administrator (s 411(7) of the Act).

It is important that a member of a regulated population subject to oversight by ASIC fulfills these roles. It is also essential that such a person has experience in dealing with financially distressed entities and has the appropriate professional indemnity insurance in place. Registered liquidators meet these requirements.

With the commencement of the *Insolvency Law Reform Act 2016* (Cth) (ILRA) in March 2017, the process for obtaining registration as a liquidator was changed to allow more scope for who could obtain registration while maintaining the standards required of such a role. As such, there is capacity for appropriately qualified people to obtain their registration. Importantly, the ILRA also specified a range of minimum educational and experience requirements to ensure the competency of a person fulfilling these roles. No other registered population exists, or needs to exist, to fulfil this role.

Importantly, while some legal practitioners are of the view that they could undertake the role of a monitor and/or scheme administrator, law societies nationally do not accept a requirement for the specific specialist sub-qualifications that would be needed to undertake such a role. Further, lawyers would not have the professional indemnity insurance to cover such work and fall outside the scope of regulation by ASIC. Lawyers can, of course, apply to become registered liquidators since the introduction of the ILRA.

A registered liquidator acting in these roles is not an 'island' or 'silo' and will be supported by the necessary lawyers and other advisors appropriate for the company or corporate group involved – similar to the multi-faceted professional service currently offered for entities during a period of external administration.

Is it worth making these changes?

In our view, yes.

In the United Kingdom, the new restructuring plan has been used nine times in the first 12 months of operation (2020/21 financial year). The fact that it is used to restructure large businesses makes it a very useful option that is worth maintaining within the insolvency regime in the United Kingdom.[1]

Similarly, a process that effectively provides an option for the restructuring of large to very large companies in Australia is worth putting in the effort to develop, even if it is only used several times a year. The dollar value of an effective restructuring for such entities – and the supporting level of jobs and flow-on impacts for suppliers, customers and the broader Australian economy – is immense.

To support this process, consideration should be given to appointing more judges to the Federal Court of Australia with specific, in-depth insolvency and practical corporate and commercial experience.

Questions posed in the consultation paper

ARITA has responded to the questions raised in the consultation paper and those responses are attached at Appendix C.

As always, we look forward to continuing to work closely with Treasury and the Government generally to ensure that any changes to schemes of arrangement are efficient and effective, to assist in both driving economic recovery from the COVID-19 crisis and contributing to Australia's long term economic success.

Yours sincerely

John Winter
Chief Executive Officer

[1] https://www.pwc.co.uk/services/business-restructuring/insights/restructuring-plans-what-difference-year-makes.html#sec2

About ARITA

The Australian Restructuring Insolvency and Turnaround Association (ARITA) represents professionals who specialise in the fields of restructuring, insolvency and turnaround.

We have more than 2,200 members and subscribers including accountants, lawyers and other professionals with an interest in insolvency and restructuring.

Around 80% of Registered Liquidators and Registered Trustees choose to be ARITA members.

ARITA's ambition is to lead and support appropriate and efficient means to expertly manage financial recovery.

We achieve this by providing innovative training and education, upholding world class ethical and professional standards, partnering with government and promoting the ideals of the profession to the public at large. In 2020, ARITA delivered 70 professional development sessions to over 8,200 attendees.

ARITA promotes best practice and provides a forum for debate on key issues facing the profession.

We also engage in thought leadership and public policy advocacy underpinned by our members' knowledge and experience. We represented the profession at 15 inquiries, hearings and public policy consultations during 2020.

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Appendix A: Summary of ARITA's proposed amendments to Australia's scheme of arrangement process under Part 5.1 of the *Corporations Act 2001* (Cth) (Act)

Legislative structure

- Limit current Part 5.1 of the Act to solvent restructures or compromise of financiers and consider moving out of Chapter 5.
- Create a new Part 5.1A of the Act which is available only to companies in financial distress (coextensive with the United Kingdom approach). Create a new name for this process, such as 'restructuring scheme'. This must be significantly different to the names used during a small business restructuring (SBR) under Part 5.3B of the Act.
- Preceded by a moratorium.
- Debtor-in-possession (DIP) administration.

Overview

Based on the current scheme of arrangement process in the Act (court approval/meeting structure) but with:

- Eligibility confined to companies in financial distress.
- Precursor moratorium.
- Moratorium creditors to be paid during moratorium and priority treatment in the event of liquidation.
- Cross class cram down.
- Rescue finance with priority.
- Amended voting thresholds.
- Court approval of any arrangement that results in employee entitlements of redundant employees being treated differently to liquidation (if liquidation occurred at the commencement of the moratorium).
- Inclusion of recoveries from related parties.

Moratorium

Period

- Directors can resolve to appoint a monitor in the same way as appointing a voluntary administrator.
- Directors must sign a declaration that the company is, or is likely to become, unable to pays its debts (similar test to voluntary administration).
- If there is a winding up application on foot, an application for the appointment of a monitor must be made to the court. This is to prevent the appointment of a monitor to hinder or delay the hearing of a winding up application. Where the company is subject to

an outstanding winding up petition, the court may make an order for a moratorium only if it is satisfied the company is likely to be able to propose a restructuring scheme which has a reasonable prospect of rescuing the company or business as a going concern.

- 20 business days for the first period and can be extended by application to the court (same as the United Kingdom approach).
- Creditors have a right to object to the extension, but not in relation to the initial 20 business day period.
- Express requirement for the monitor (this role is outlined below) to terminate the moratorium if in their view the company is unlikely to be able to propose a restructuring scheme which has a reasonable prospect of rescuing the company or its business as a going concern (same as the United Kingdom approach).
- No liability for insolvent trading for directors or monitor during this period.
- Monitor provides notice of the appointment to creditors.
- Ends when the restructuring scheme commences or is rejected by the court at the second hearing, unless there is a delayed commencement of the restructuring scheme. However, there should be a maximum period that the moratorium can continue post-court approval to prevent protracted delays that compromise creditors' enforcement rights.
- Will also end if monitor terminates the moratorium or the end of the moratorium period is reached with no proposal having been put to creditors.

Appointee

- A registered liquidator to be appointed as monitor for the moratorium period. The monitor would be entitled to act in any subsequent restructuring scheme as the scheme administrator, but not in any other external administration in the event that the restructuring proposal is not accepted or is not successful, unless consent is given by the court to do so. This is because the role as monitor/scheme administrator is acting for the company and advising the directors and therefore would not be independent in a subsequent external administration, during which time the appointee would need to review actions taken during the moratorium and/or restructuring scheme.
- It is not envisaged that there would be an automatic conversion to liquidation in the event of termination of the moratorium or restructuring scheme.
- Role is to ensure the company is meeting its obligations duringthe moratorium and to assist the directors with preparing the scheme proposal and the process for putting the scheme proposal to creditors for a vote.
- The monitor will also conduct the meetings of the classes of creditors to vote on the scheme proposal, rule on creditors' claims and undertake the administrative processes associated with these meetings. Creditors can object to how claims are ruled on.
- The monitor will not be responsible for trading the business of the company – that remains the responsibility of the directors.
- The company will be responsible for paying the monitor's fees and expenses on the basis agreed with the company at the time of the monitor's appointment.

Treatment of debts incurred

- Australia’s insolvency regime is based on protecting debts incurred during external administrations with personal liability of the external administrator. The position in the moratorium needs to balance the rights of creditors with the space to successfully restructure the company.
- Under the United Kingdom’s standalone moratorium, there is a system of dividing creditors’ claims between moratorium and pre-moratorium debts, and then pre-moratorium debts are further divided into debts for which there is a payment holiday and debts for which there is not a payment holiday.
- Pre-moratorium debts with a payment holiday do not have to be paid during the moratorium and can be dealt with in any subsequent restructure.
- Moratorium debts and pre-moratorium debts without a payment holiday need to be paid in the ordinary course during the operation of the moratorium in order for the moratorium to be permitted to continue.
- Pre-moratorium debts without a payment holiday are those pre-moratorium debts which have fallen due before the moratorium or which fall due during the moratorium and which are amounts payable in respect of:
  - the monitor’s remuneration and expenses (for the period of the moratorium);
  - goods and services supplied during the moratorium;
  - wages or salary arising under a contract of employment;
  - redundancy payments;
  - rent in respect of a period during the moratorium; and/or
  - debts or other liabilities arising under a contract or other instrument involving financial services – which includes a loan agreement (unless they came due as a result of the exercise of an acceleration or early termination clause).

- All other pre-moratorium debts are pre-moratorium debts with a payment holiday.
- The United Kingdom approach is a relatively simple, effective way of balancing the interests of creditors during the moratorium period. If a restructuring scheme is accepted by creditors and approved by the court, the debts of creditors with pre-moratorium debts with a payment holiday are dealt with in the restructuring scheme. If there is no restructuring scheme, those amounts become a debt claimable in any subsequent external administration, or against the company in the event of no subsequent external administration. This delivers a fair and equitable outcome for creditors.
- We propose a similar arrangement for a moratorium that precedes a restructuring scheme. However, redundancy payments should not be included in this payment system – rather, they should be dealt with as part of the restructuring scheme.
- Should the scheme proposal not be accepted by creditors and/or approved by the court and the company ends up in liquidation, any debts that were required to be paid during the moratorium that remain outstanding would be entitled to a priority in the liquidation under s 556(1)(a) of the Act.

Other effects of the moratorium

- Similar to voluntary administration (which has largely been adopted in the new SBR process too).

- Secured creditors are bound by the moratorium, including secured creditors with security over the whole or substantially the whole of a company's assets (unlike voluntary administration). However, secured creditors have a right to apply to the court to object to this and to the continuation of the moratorium at the end of the first 20 business day period.

Rescue financing

- Once a moratorium period applies (or during the period of a restructuring scheme), the company may obtain rescue financing, with new funds advanced entitled to a 'super priority'
- It is recommended that this process is kept simple to prevent lengthy court applications disputing the rescue finance priority which would prevent or delay the provision of the necessary finance to move forward with the restructuring.

Restructuring scheme

Proposal

- Full report to creditors in a format similar to a voluntary administrator's report – should compare restructuring scheme to liquidation for each class and report on recoverable transactions. This ought to be prepared by the monitor.
- Restructuring scheme can include automatic termination clauses.
- Termination of a restructuring scheme should work in the same way as a SBR – that is, no automatic liquidation unless ordered by the court.
- New share issues can be considered as part of the proposal (with shareholders being one of the classes that must approve the restructuring scheme in this case).

Appointee

- Scheme administrator to be appointed under the terms of the scheme proposal – scheme administrator can be the monitor though can also be someone different. Must be a registered liquidator.
- Fees and expenses to be paid by the company on the basis set out in the scheme proposal.
- Scheme administrator ensures compliance by the company with the terms of the Restructuring scheme – removes onus on creditors to monitor and potential additional costs of court applications to enforce.
- Scheme administrator will distribute payments to creditors after ruling on proofs of debt submitted. Follow process for liquidations.
- Deals with any defaults under the restructuring scheme by the company (which may also require a court application and/or meeting of creditors).

Voting

- Rather than the current majority in number and 75% in value approval threshold adopted for schemes of arrangement in Part 5.1 of the Act (noting that Part 5.1 can be used for both solvent and insolvent restructures), we recommend that the voting approval

thresholds required to be satisfied for each class in the restructuring scheme be bought in line with all other external administrations and require approval by the majority in number and majority in value of each class.
- For the purpose of voting on the scheme proposal, there should be no casting vote.
- Related parties should be excluded from voting – consider amendments to the definition of 'related party' for voting purposes, noting that a company of a relative of the director is not currently considered to be a related party.

Meeting process

- Use IPS/IPRs.
- Would include shareholders as a class where a share dilution or sale is proposed to occur.

Cross class cram down

- Should be included in the new restructuring scheme process, subject to court approval to ensure the interests of creditors are appropriately protected.
- Prevents dissenting classes of creditors from, in effect, 'holding out' in the pursuit of individual interests while precenting the potential for a successful restructuring which is to the maximum benefit of all creditors.
- Adopt a similar process to the United Kingdom restructuring plan, with no absolute priority rule (distinct to the United States and Singapore approach, both of which incorporate the absolute priority rule).
- Could include cram down of shareholder class.
- The cross class cram down would operate so that, in effect, the court could approve a plan if it is satisfied that:

    - members of the dissenting classes would not be any worse off than they would be in the event of a relevant alternative (usually liquidation); and
    - at least one class of creditors that would receive a payment or that has a genuine economic interest in the company in the event of a relevant alternative has voted in favour of the plan.

Employees

- A restructuring scheme proposal has the potential to be used to move assets around the corporate group structure and leave some companies with redundant employees and no assets.
- Accordingly, where the restructuring scheme seeks to change how employee entitlements would be treated compared to the situation if the company was wound up using the corporate structure and assets that were in place at the time of entering into the moratorium, this issue must be specifically considered and approved by the court in order to avoid the restructuring scheme being an agreement or transaction to avoid employee entitlements under Part 5.8A of the Act.
- The cross class cram down approval is not sufficient protection, as retained employees may be able to 'out vote' retrenched employees, thus obtaining the consent of the class.

- The court will need to be satisfied that the employees are no worse off that what they would have been in a liquidation and thus will be no more reliant on any government safety net scheme than what they would have if the company had gone into liquidation (at the time of the commencement of the moratorium).
- On this basis, employees should be entitled to access any government safety net scheme for any outstanding entitlements (subject to the limits of the safety net scheme) after they have received any payments from the restructuring scheme.

Recovery actions

- Extend director related payment recoveries to new restructuring schemes and voluntary administration/DOCAs. This reduces the potential for the new process to be misused by directors to protect their own interests, and can also be contracted out of subject to the approval of creditors when a scheme is put to a vote.

Who should it apply to?

- From an insolvency perspective, all companies experiencing financial distress. However, the government may choose to exclude some types of companies/businesses from a public policy perspective, such as APRA-regulated entities which are subject to a very specific prudential regulatory regime.

Corporate groups

- Provision should be made for dealing with corporate groups to allow for the efficient holding of meetings and consideration of the scheme proposal by the different classes of creditors within each company in the group.

Appendix B: Comparison of existing Schemes to ARITA's proposed Restructuring Arrangement

Current	Proposed
General	***General***
• Not an external administration	• An 'external administration' as defined in Schedule 2 Insolvency Practice Schedule of the Act
• Solvent and insolvent restructuring (note we propose the current schemes process be retained for solvent restructuring only)	• Only available to companies in financial distress. Directors to make declaration that company is insolvent or likely to become insolvent (like VA)
Pre-scheme	***Moratorium***
• Ipso facto moratorium from announcement that application being made or application made whichever is earlier (s 415D) • DIP model – directors trade • No protection for creditors • No stay on insolvent trading (unless safe harbour is applicable or another external administration has been commenced) • No independent oversight • Court made order a moratorium under s 411(16)	• VA-type moratorium (includes ipso facto) from appointment of a monitor (who must be a registered liquidator) by directors – but wider than the VA moratorium in that secured creditors are also bound, including those with security over the whole or substantially the whole of a company's assets • 20 business days unless extended by court application – creditors have the right to object to the extension • DIP model – directors trade • Certain debts must be paid during the moratorium (essentially debts incurred during the moratorium). Monitor to consider this when assessing termination of moratorium • Stay on insolvent trading (for directors and monitor) • Ends when restructuring scheme either approved by court or rejected, or if application not made to court to approve meetings for scheme proposal within moratorium period (or extended period), or if terminated by monitor • Express for the monitor to terminate the moratorium if in their view the company is unlikely to be able to propose a restructuring scheme which has a reasonable prospect of rescuing the company or business as a going concern

Current	Proposed
	• If moratorium comes to an end without the scheme process having commenced, control returns to the directors (like an SBR) – act of insolvency
• Scheme terms developed	• Same
• Court may require a report from ASIC or another person specified by the court, to give a report to the court (s 415)	• Same except the report should come from the monitor
• No rescue finance	• Rescue finance with super priority (subject to court oversight)
Approval of Scheme	***Approval of Restructuring scheme***
• Application made to court for an order to convene meetings of classes of creditors (notice given to ASIC who must have reasonable opportunity to appear) (s411)	• Same
• Section 414 provides a process for the acquisition of shares of shareholders dissenting from scheme or contract approved by the majority	• Restructuring scheme can provide for new share issues or acquisitions of shares as part of the proposal, with shareholders being one of the classes (similar to s 444GA process)
• No provision for director related payment recoveries	• Restructuring scheme can provide for director related payment recoveries – reduces misuse by directors to protect their own issues. These recoveries can also be contracted out of subject to creditor approval when the scheme is put to a vote
• Notice of meeting and explanatory statement (as approved by the court) sent to creditors (s 412)	• Same but explanatory statement should contain information similar to VA report. This report could also be the report provided to the court by the monitor.
• Meeting of creditors held and each class of creditors vote on whether to accept the scheme • Meetings can be held on a consolidated basis where more than 30 companies and certain circumstances met • All classes must accept the scheme – majority in number and 75% in value of creditors present and voting	• Same but voting should be majority in number and at least 50% in value of creditors present and voting in each relevant class • Monitor will manage the meeting process and rule on creditor claims for voting purposes • Follow process set out in IPS/IPRs
• Related creditors can vote but court has the power to disregard vote	• Related creditors can't vote

Current	Proposed
• No cross class cram down (CCCD)	• CCCD allowed to enable scheme to become binding on dissenting classes – has to be approved by the court
• Matter returns to court for final approval of the scheme (ASIC must provide a statement of no objection) (s411(4))	• Same • Plus consideration and approval of CCCD • Plus approve any arrangement where employee entitlements of redundant employees are treated differently, but no worse off than liquidation as if it occurred at the time of moratorium commencing (employees then have access to FEG for any outstanding entitlements) • ASIC notified and has the right to object, but there is no mandatory obligation on ASIC to respond.
• Scheme not binding on creditors until court order lodged with ASIC (s 411(10))	• Restructuring scheme binding on creditors once approved by the court
Scheme	***Restructuring scheme***
• Scheme administrator must be a registered liquidator unless court gives leave (s 411(7))	• Same
• Scheme implemented	• Same • Scheme administrator responsible for ensuring compliance with the terms of the scheme and dealing with any non-compliance • Non compliance – restructuring scheme can be terminated by court application, or by automatic termination clause in the scheme • Termination of the restructuring scheme results in the return of the company to directors (same as SBR)
• Annual and end of administrations returns (adopt receivership provisions) (s 411(9))	• Same but as now an external administration, covered under IPS and IPRs

Appendix C: Response to questions posed in the Consultation paper

Question from discussion paper	ARITA Platform for recovery	PC Report	Other ARITA comments+
Question 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?	Specific provision for application to the court for a moratorium to apply while a scheme is negotiated, including a restriction on the exercise of ipso facto clauses.	The *Corporations Act 2001* (Cth) (Act) should be amended to create a moratorium on creditor enforcement actions during the formation of schemes of arrangement. This should be aligned with the approach used in voluntary administration.	Moratorium should apply specifically in relation to a financially distressed entity and should be for an initial 20 business day period commencing on the appointment of the monitor. The issue will be responsibility for debts during the moratorium with no appointed insolvency practitioner with personal liability (there is a similar issue in the context of a SBR). The UK's standalone moratorium provides an effective solution in this regard – the company must continue to pay pre-moratorium debts without a payment holiday and moratorium debts during the operation of the moratorium (see further detail in Annexure 1). Our suggested approach is outlined in the paper at Appendix A.
Question 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?		The Act should be amended to create a moratorium on creditor enforcement actions during the formation of schemes of arrangement. This should be aligned with the approach used in voluntary administration. Courts should also be given the explicit power to lift all or part of the moratorium in circumstances where its application would lead to unjust outcomes.	Voluntary administration is a good starting point but the UK's standalone moratorium provides an ideal structure for dealing with the payment of debts that continue to be incurred during the operation of a moratorium. This is covered in more detail in the paper at Appendix A. Retaining court control over extensions of the moratorium ensures that the moratorium cannot be used to perpetuate creditor abuses.

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Question 3: When should the automatic moratorium commence and terminate? Are complementary measures (for example, further requirements to notify creditors) necessary to support its commencement?			Moratorium should commence on the company's appointment of a monitor. Directors need to resolve that the company is insolvent or likely to become insolvent. The moratorium should terminate when the scheme commences – i.e. when approved by the court unless there is some provision which delays commencement. But there should be a maximum period that the moratorium can continue post-court approval to prevent protracted delays that compromise creditors' enforcement rights. If the Scheme is not accepted or the monitor terminates the moratorium, then the moratorium comes to an end. Notice to creditors ought to be mandated in the same way as during a SBR.
Question 4: How long should the automatic moratorium last? Should its continued application be reviewed by the Court at each hearing?			The court should consider the continued operation of the moratorium at each hearing. At the end of the initial 20 business day moratorium period, the company would have to apply for an extension of the moratorium if the matter is not otherwise due to be heard before the court in connection with the first hearing to approve creditor meetings. Creditors should have the right to object to the extension.
Question 5: Are additional protections against liability for insolvent trading required to support any automatic moratorium?			There should be a safe harbour from insolvent trading liability, as occurs during a SBR, once the moratorium commences for both directors and the monitor.

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Question 6: What, if any, additional safeguards should be introduced to protect creditors who extend credit to the Company during the automatic moratorium period?	Ability to recover director-related antecedent transactions in schemes (and deeds of company arrangement (DOCAs)) to reduce their misuse by directors. Directors to have the ability to contract out of this liability with the relevant administrator in both schemes and DOCAs.		Requirement to pay in the ordinary course (discussed above) and priority payment in any subsequent liquidation if a restructuring arrangement does not proceed. We also recommend that the scheme administrator has the ability to recover related party transactions but there ought to be an ability to contract out of that in the scheme document if there is creditor or court consent. There are various creditor protection mechanisms that operate during the UK standalone moratorium, as discussed in further detail in the paper at Appendix A.
Question 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?			ARITA does not support this proposal, unless the court specifically consents to the appointment. This is on the basis that: - A scheme is akin to a SBR in that the scheme administrator is assisting the directors of the company rather than acting independently for the creditors (as occurs during voluntary administration). - Any subsequent external administration will be a unique appointment as there is no automatic transition to liquidation as occurs when a period of voluntary administration or DOCA. - A liquidator will have to consider actions taken during the moratorium and restructuring arrangement, including the actions taken by the restructuring administrator in assisting and advising the directors. If the liquidator had been the restructuring administrator then the liquidator would be reviewing their own work.

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Question 8: Is the current threshold for creditor approval of a scheme appropriate? If not, what would be an appropriate threshold?	Removal of related party voting in a scheme of arrangement (and voluntary administration/DOCAs) and reduction of voting requirements to majority threshold in line with those in a voluntary administration/DOCA.		Consider majority approval in number and value by each creditor (and, if relevant, shareholder) class, aligning the scheme process with the voluntary administration/DOCA approval thresholds. However, a cross class cram down ought to be made available to bind dissenting classes with court approval, as occurs under the comparative UK and Singapore processes. This is discussed in further detail in the paper at Appendix A.
Question 9: Should rescue, or 'debtor-in-possession' (DIP), finance be considered in the Australian creditors' scheme context?	Statutory provision should be made for DIP financing during the operation of a scheme (or a period of voluntary administration/a DOCA).		ARITA supports this proposal. This is considered in further detail in the paper at Appendix A.

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Question 10: What other issues should be considered to improve creditors' schemes?	Voting using purchased debts to be limited to the value of consideration paid, consistent with the current requirements in the *Bankruptcy Act 1966* (Cth). Consideration should be given to the implementation of a 'Schemes Panel' to replace the court's oversight of schemes of arrangement. It is envisaged that this Panel would operate in a similar manner to the Takeovers Panel and be a government-regulated peer review panel.	The Commission considers that the introduction of a specialist reconstruction panel is not warranted at this time.	Restriction on related party voting and the adoption of a cross class cram down (see Question 8 above).

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Question 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?			**Cross Border** The Virgin Atlantic restructuring plan (executed under the new UK restructuring plan – see further details on the nature of this process in Annexure 1) was recognised in the US as a foreign main proceeding. It is envisaged that an Australian restructuring arrangement would similarly be readily recognised as a foreign main (or at least a foreign non-main) proceeding under the UNCITRAL Model Law on Cross Border Insolvency depending on the location of the company's centre of main interests and/or establishment. **FEG** Note employees have to be paid for wages during the moratorium (if the UK model is followed). There will be an issue with redundancy. The Paper at Appendix A contains a discussion of how employee entitlements should be dealt with to protect employees, while allowing for a cross class cram down and protecting the integrity of the safety net scheme.

Annexure 1 – Restructuring Mechanisms – Overview

	Chapter 11 (US)	Scheme of Arrangement (Singapore)	Part A1 Moratorium (UK)	Scheme of Arrangement (UK)	Restructuring Plan (UK)	Scheme of Arrangement (Aus)	Voluntary Administration/ DOCA (Aus)	ARITA Position/ Recommendation
Main objectives	A reorganisation plan proposed by a debtor to keep its business alive and pay creditors over time – the 'classic' DIP model.	Intended to be a 'best of both worlds' hybrid between a UK scheme of arrangement and the US Chapter 11 process, substantial amendments were made to Singapore schemes of arrangement in 2017. Under the new scheme of arrangement process, it is now possible for a debtor company to enter into an agreement with its creditors to restructure rights and liabilities – with the added benefit of a pre-scheme enforcement moratorium as well as a cross-class cram down which	This is a stand-alone process – unlike Singapore schemes of arrangement, it is not 'built into' a scheme of arrangement or a restructuring plan but stands outside both processes and can be used by a debtor company to seek to negotiate either of those outcomes *or* an informal workout *or* as a precursor to some other formal insolvency process (e.g. a creditors' voluntary arrangement). Operates to prevent the enforcement of unsecured and secured debts. Can only be resorted to by 'eligible' insolvent	Binding, court-approved agreement which allows reorganisation of the rights and liabilities of members and creditors of a company.	Introduced in June 2020 as a more flexible form of scheme of arrangement – dubbed 'the super scheme'. Unlike an ordinary scheme, can only be resorted to by a company which has 'encountered or is likely to encounter financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern'. Incorporates a cross-class cram down so that court can order a restructuring plan to become binding on dissenting classes of creditors (subject to appropriate safeguards).	Binding, court-approved agreement that allows reorganisation of the rights and liabilities of members and creditors of a company.	Provides a mechanism to maximise the prospect of a business continuing in existence or at the very least, providing a better return to creditors.	The new Singapore and UK processes reflect a strong public policy intention to provide enhanced flexibility which maximises the prospect of a viable company being able to restructure its affairs, with the benefit of enforcement moratoria and more flexible creditor voting arrangements, while also still providing for important creditor protections. This is desirable in Australia also – albeit in this country, there has long been resistance to and mistrust in DIP models and a 'creditor

	Chapter 11 (US)	Scheme of Arrangement (Singapore)	Part A1 Moratorium (UK)	Scheme of Arrangement (UK)	Restructuring Plan (UK)	Scheme of Arrangement (Aus)	Voluntary Administration/ DOCA (Aus)	ARITA Position/ Recommendation
		applies to creditor voting.	entities (there is a broad list of excluded companies – e.g. banks, insurance companies and electronic money institutions). Strict eligibility requirements – directors must state that the company is, or is likely to become, unable to pay its debts and an independent monitor (appointed to oversee the process) must be of the view that the moratorium is likely to result in the rescue of the company as a going concern.					enforcement' culture. Should be introduced as an insolvency-specific scheme, with a similar commencement criterion to a UK restructuring plan, but with a pre-scheme moratorium incorporated as part of this new type of scheme (as is the case in Singapore but distinct from the standalone Part A1 moratorium in the UK).
Director liability	No exposure to insolvent trading offences.	Potential liability for wrongful trading for debts incurred while a scheme is negotiated.	No wrongful trading liability provided the company pays permitted moratorium period debts (i.e. pre-moratorium debts for which there is a payment holiday	Potential liability for wrongful trading for debts incurred while scheme is negotiated – unless a Part A1 moratorium is in place and company pays permitted	Potential liability for wrongful trading for debts incurred while scheme is negotiated – unless a Part A1 moratorium is in place and company pays permitted	Offences for trading while insolvent.	Offences for trading while insolvent.	Early intervention would increase the likelihood of return to creditors – consider a moratorium as part of a new 'restructuring arrangement' in Australia but with a safe harbour from

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			and moratorium debts).[2]	moratorium period debts.	moratorium period debts.			insolvent trading liability if certain permitted debts are paid. This is a hybrid of the Singapore model (insofar as the moratorium is part of the scheme of arrangement process, not a standalone process in itself) and the UK model (itemising specific debts that the company must continue to pay during the moratorium).
Who is appointed/ oversees the process	DIP model - overseen by Bankruptcy Court.	DIP model – overseen by the courts.	Operates under the oversight of an independent monitor.	No oversight role under the scheme itself (as distinct from any Part A1	No oversight role under the plan itself (as distinct from any Part A1	Optional to appoint a scheme administrator but this is rare in practice.	Registered liquidator – known as voluntary	Insolvency scheme and pre-scheme moratorium should and necessitate the appointment of

[2] Debts are divided into pre-moratorium debts for which the company has a payment holiday, pre-moratorium debts for which the company does not have a payment holiday and moratorium debts. The company must continue to pay pre-moratorium debts without a payment holiday and moratorium debts during the operation of the moratorium, but is restricted in paying pre-moratorium debts with a payment holiday (this requires consent of the court or the monitor). Pre-moratorium debts without a payment holiday are those which have fallen due before the moratorium or which fall due during the moratorium and which are amounts payable in relation to the monitor's remuneration and expenses, goods and services supplied during the moratorium, wages or salary arising under a contract of employment, redundancy payments, rent for a period during the moratorium and debts arising under a loan agreement or some other financial services arrangement. Other pre-moratorium debts are those with a payment holiday. A moratorium debt is a new debt arising during the moratorium or one occurring due to an obligation incurred during the moratorium.

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	Lawyers and other insolvency professionals engaged – usually separate set of lawyers/insolvency professionals per stakeholder group: • Debtor company. • Secured creditor(s). • Creditor committee. • Employees	No independent monitor during period of moratorium.		moratorium invoked).	moratorium invoked).		administrator /deed administrator.	a registered liquidator as a monitor/scheme administrator to ensure creditors' interests are safeguarded. We recognise this is different to overseas models but see many benefits of an external advisor/monitor being involved in the process. Refer to the full paper at Appendix A for the tasks that the monitor/scheme administrator would attend to.
Stay of proceedings	As prescribed by law.	Automatic moratorium of 30 days upon filing of an application by debtor company – applies simply where company *intends* to propose a scheme (need not be an existing plan).	Binding on secured and unsecured creditors as well as landlords for an initial 20 business day period. Initial period can be extended for a further 20 business days by directors, for up to 12 months with creditor consent or	No moratorium incorporated as part of the scheme of arrangement – must apply separately for a Part A1 moratorium or otherwise use another formal insolvency process.	No moratorium incorporated as part of the scheme of arrangement – must apply separately for a Part A1 moratorium or otherwise use another formal insolvency process.	Currently no moratorium while a scheme is negotiated and implemented. However, ipso facto enforcement restrictions do apply.	As prescribed by law and there are also ipso facto enforcement restrictions.	A moratorium under the supervision of an independent monitor ought to be incorporated as part of a new insolvency scheme process – the moratorium ought to be coextensive with the Part A1 moratorium in the UK but should be included as part of

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		Court has power to order longer moratorium.	for longer with court approval.					the scheme process itself (as is the case in Singapore) rather than as a standalone process.
Voidable Transactions	Unfair preferences: • Undo a transfer of money or property within 90 days before filing petition (subject to defences). • Transfers to relatives, general partners, directors/officers within 12 months before filing.	Not available	Not available.	Not available	Not available	Not available	Not available	Extend director related payment recoveries to new insolvency schemes and VA/DOCAs– reduces misuse by directors to protect their own interests, but can be contracted out of.
DIP finance	Yes – court can order super-priority for rescue financing under dedicated statutory provisions.	Yes – court can order super-priority for rescue financing under dedicated statutory provisions.	Not available.	Not available absent ad-hoc court approval (no specific regime as in the US and Singapore).	Not available absent ad-hoc court approval (no specific regime as in the US and Singapore).	Not available absent ad-hoc court approval (no specific regime as in the US and Singapore).	Not available absent ad-hoc court approval (no specific regime as in the US and Singapore).	We accept that cases have allowed third party financing in a VA/DOCA, but we believe there should be a recognised process for DIP financing (including super-priority

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								status) as part of a new insolvent scheme process. This is the case in the US and Singapore and experience has shown that DIP finance is often essential to the success of a restructuring – without it, a debtor will often struggle to obtain the necessary working capital to continue to trade.
Cross class cram down	Yes. Subject to absolute priority rule – for junior creditors to receive any value, dissenting senior classes must be paid in full or receive sufficient value for their claim.	Yes. Subject to absolute priority rule.	Not relevant.	Not available.	Yes – with court approval. The court can approve a plan if it is satisfied that: • members of the dissenting classes would not be any worse off than they would be in the event of a relevant alternative (usually liquidation); and	Not available.	Not available.	A cross-class cram down should be adopted as part of a new insolvency scheme in Australia. It provides necessary flexibility to prevent dissenting classes of creditors from, in effect, 'holding out' in the pursuit of individual interests while preventing the potential for a successful restructuring which is to the maximum

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					• at least one class of creditors or members that would receive a payment or have a genuine economic interest in the company in the event of a relevant alternative has voted in favour of the plan. No absolute priority rule (in contrast to the US and Singapore).			benefit of all creditors. Similar safeguards should be adopted which exist under the UK restructuring plan, but without the absolute priority rule. That rule is overly restrictive and senior creditors are still protected under the UK alternative because they must be 'no worse off' than in the most likely alternative if the restructuring plan was not sanctioned.
Approval	2/3 of value of votes in each class	Majority in number of creditors, who represent 75% in value of the debt claims. Separately, the Singapore process allows for a 'pre packed' scheme of arrangement, so that the court can approve a scheme without creditors' meetings having	Only required if moratorium is sought to be extended beyond initial 20 business day period.	Majority in number of creditors, who represent 75% in value of the debt claims.	Majority in number of creditors, who represent 75% in value of the debt claims.	Majority in number of creditors, who represent 75% in value of the debt claims.	Majority in number and value.	The majority in number of creditors, who represent at least 50% in value of the debt claims (like VA) should be used as part of the new insolvency scheme. This makes voting consistent across all external administrations. No casting vote.

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		been called, *provided* the court is satisfied that the scheme would have been approved had creditors voted on it. This is intended to provide greater flexibility and speed.						The Singapore alternative of a 'pre packed' scheme should not be incorporated as part of a new insolvency scheme in Australia. Although the Singapore process provides the safeguard of court approval, it is preferable for actual meetings to be held to ensure creditors have a voice and are accorded procedural and substantial fairness.