



TAYLOR WOODINGS

NEWS FLASH

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2010 Corporate Insolvency Reform – *Sons of Gwalia* to be reversed

The Proposed Reforms

This week the Federal Minister for Financial Services, Superannuation and Corporate Law, the Honourable Chris Bowen, announced sweeping reforms to Australia's Corporate Insolvency Laws following concerns raised by the insolvency and banking industries in the wake of the High Court *Sons of Gwalia* decision. These changes will reverse the effect whereby certain claims by shareholders for compensation rank equally with other unsecured creditors in a winding up. This includes the removal of the right to vote in insolvency proceedings unless ordered by the Court. The remaining reforms will bring into line some of the anomalies and technical issues in corporate insolvency law.

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What does this mean for Directors, Shareholders and Financiers?

For Directors: the reforms will mean that refinance options aimed at restructuring viable businesses will become less expensive and more readily available as certainty in creditors' rights is restored. The proposed changes to the insolvent trading laws will make informal workouts more attractive to directors. The reversal of *Sons of Gwalia* may however open up directors to being personally sued by shareholders in the event of a corporate collapse.

For Shareholders: their position will return to the well established pre-decision status whereby they will need to be vigilant in making decisions in light of the risk they accept when investing in listed companies and the lack of voting power they will have in the event of an insolvency.

For Financiers: the reforms will reduce much of the uncertainty about their rights when providing finance for a restructure and re-establish the power of their vote in decision making in insolvency situations.

Key Questions Raised

- Do the reforms have any impact on determinations as to whether a company is solvent or not given that the paper does not try to deal with issues regarding assessing (in)solvency?
- The reforms may allow companies to more easily raise funds at a better price for a restructure, providing greater flexibility in avoiding insolvency. But could these reforms actually increase the appetite of credit providers to force insolvency proceedings now there is a smaller group of creditors, sharing the pool of funds?
- The reforms do nothing to diminish a shareholder's ability to bring an action under alternative legislation. Could the reforms force shareholders to sue directors personally rather than pursue the companies?



- The *Sons of Gwalia* decision only afforded protection to shareholders who believed they had been misled by directors via publicly released information e.g. annual reports. Could these reforms actually benefit shareholders who cannot claim misleading conduct by allowing a restructure and improving the financial position of the company and the value of their shares?

Taylor Woodings View

The Government's proposed reform package is welcome in that it removes uncertainty in the law in respect of certain shareholders rights and will reduce the complexity and cost of administering insolvency situations. The proposed reforms restores the traditional priorities afforded to creditors that extend credit to companies.

Return to the past for Shareholders

Prior to the decision in *Sons of Gwalia*, shareholders equity position in winding up ranked behind the position of creditors. The reason being that shareholders took on investment risk which was seen differently to the business risk taken on by creditors in extending credit to companies. Financiers priced their debt according to that risk. *Sons of Gwalia* in giving equal right to some equity claims shifted the balance in a winding up. The flow on has been that companies in genuine need of a restructure through formal or informal avenues found that the price of debt in the market increased as financiers became uncertain of their rights. The decision also added more complexity and costs to the conduct of external administrations by insolvency practitioners, and ultimately reducing the returns to stakeholders.

Mr Bowen in announcing the return to the regime that existed before the decision stated that addressing the increased cost of company finance outweighed the benefits to aggrieved shareholders who might be able to claim compensation. By removing the right to vote, the balance of power has shifted back to creditors lending weight to the Government's view that the priority of shareholders is subrogated behind that of creditors.

Other Insolvency Reforms for 2010

The Government also has planned changes to the *Corporations Act* to reflect a range of issues that have been raised since the *Corporations Amendment (Insolvency) Act 2007* was introduced. These reforms include:-

- Streamlining provisional liquidator's remuneration approval;
- Facilitating electronic notice to creditors including a central website for advertising notices;
- Empowering ASIC to take control of records in the event of a vacancy on the office of an external administrator;
- Aligning the rules of former name disclosure in insolvency situations;
- Reducing the regulatory burden on insolvency administrations;
- Removal of anomalies in respect of relation back and commencement dates of liquidations;
- Mandating a requirement to notify creditors of a material breach of a Deed of Company Arrangement; and
- Addressing minor drafting issues in existing legislation.

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Insolvent Trading Discussion Paper

Mr Bowen also released a discussion paper outlining a range of possible reforms for business rescue options outside the formal external administration regime. A key platform to this discussion paper is the provision of a “safe harbour” for directors from insolvent trading laws where there were attempts by directors to facilitate genuine work outs. The existing insolvent trading laws provide some disincentive to informal restructures. The paper discusses three possible options for future reform in this area to address concerns that the insolvent trading laws may cause some companies to be placed into external administration early or unnecessarily for a fear of personal liability.

Option 1 – Status Quo

No change to the current law where directors must ensure that the company remains solvent when seeking to reorganise outside a formal external administration.

Option 2 – Modified Business Judgement Rule

A directors duty not to trade whilst insolvent would be satisfied if the business judgement rule in section 180 of the *Corporations Act* is met together with the following modifications:-

- The financial records presented a true and fair picture of the company’s financial position;
- The director was informed by restructuring advice from a qualified and experienced professional with access to the “true and fair” accounts as to the feasibility of the company remaining solvent or was returned to solvency in a reasonable period;
- The director’s business judgement that the interests of the company’s creditors and members as a whole were best served by the restructure; and
- The restructuring was diligently pursued by the director.

Option 3 – Moratorium

Directors would be able to invoke a moratorium from the duty not to trade whilst insolvent for the purposes of attempting a restructure outside external administration. The moratorium could be terminated by creditors.

The safe harbour proposal is considered to provide a higher degree of protection for directors from the threat personal liability for trading whilst insolvent during bona fide restructuring attempts outside of the formal external administration regime. The purpose of the safe harbour is to provide an avenue to legitimately attempt to reorganise a company to restructure the business and save jobs rather than bury a company through liquidation.

These proposals seek to balance the opportunities of a successful restructure attempt with the duties of directors to be aware of the company’s financial situation and their responsibility to stakeholders. However, any safe harbour proposal runs the risk that there is potential for abuse of the rule or ongoing credit providers may be more at risk trading with a company operating in a safe harbour.

The discussion paper is welcome as less costly informal corporate reorganisation will be keenly sort by business as the economy seeks to recover from the Global Financial Crisis.

Submissions on the proposal are sought by 2 March 2010.

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How Taylor Woodings can assist

Taylor Woodings has extensive experience with formal and informal corporate restructuring and insolvency. Across all appointments, we work hard to find practical solutions to the challenging situations that we face with the desired aim of maximising returns for all stakeholders.

Some of our recent formal corporate insolvency appointments include:

- Acting as administrators and deed administrators of a national e-commerce and vocational training organisation with offices in all state capital cities and which operated through 9 companies, as part of which we worked with all stakeholders to establish a pooled Deed of Company Arrangement for all 9 companies.
- Acting as administrators and liquidators of a high profile vocational education college in New South Wales with more than 35 staff and 500 students, as part of which we worked with Federal and State government and student representatives to find a successful outcome for the 500 students affected by the external administration.
- Acting as external administrators of listed mining companies with assets in Australia and overseas.
- Acting as Court appointed liquidators of a group of investment companies on application of the Australian Securities and Investments Commission following complaints from investors.

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Confidential discussion

If you wish have a confidential discussion about any aspect of formal or informal restructuring or issues raised in this newsletter, please contact one of our Taylor Woodings Partners or Associate Directors in Sydney, Perth or Melbourne.

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