

# A TO Z

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## OF INSOLVENCY AND RESTRUCTURING



# A

## **Amortisation**

Amortisation of assets is the decrease in value of those assets over a period of time. Amortisation of loans is the process of paying off a debt over time through regular payments.

# B

## **Bankruptcy**

An insolvency procedure which relates to a natural person as opposed to a company.

## **Bond**

An interest bearing security issued by governments and companies as an alternative way to raise capital which can be traded on the open market.

# C

## **Capital Structure**

The composition of a company's mixture of debt and equity funding.

## **Credit Bid**

This mechanism allows a secured creditor to acquire the assets of the debtor (which are the subject of its security) in exchange for a full or partial cancellation of the debt. This enables a secured creditor to acquire the assets without paying any actual cash for the assets.

## **Cram down**

Cram down is a US Chapter 11 concept where a plan may be imposed on a group of dissenting creditors (including secured creditors). Cram down is not available in a scheme of arrangement process but is available in a DoCA process to cram down shareholders subject to an order of the Court (section 444GA).

## **Circulating Asset**

Historically referred to as "floating charge" assets, circulating assets are assets which a company is typically entitled to deal with, use or dispose of in the ordinary course of business without the need to obtain a secured party's consent.

Examples of circulating assets are stock, debtors and cash.

Certain employee entitlements will be paid out of circulating assets ahead of creditors holding security over circulating assets in insolvency.

# D

## **Debt for Equity**

An agreement by creditors to convert their debt into shares so that they become shareholders in the debtor instead of creditors. The conversion is technically achieved either by the creditors releasing their debt to the extent of the subscription price for the new shares or setting off their debt against their liability for the subscription price on the shares.

## **Deed of Company Arrangement**

An insolvency procedure which is instigated via the voluntary administration process. A deed of company arrangement (commonly referred to as a DoCA) is a binding arrangement between a company and its creditors which sets out how the affairs and assets of the company will be dealt with.

Whether a company enters into a deed of company arrangement is determined on the vote of creditors at the second meeting of creditors (discussed below under Voluntary Administration) – for a DoCA to be successful, a majority in value and a majority in number of creditors must vote in favour of the DoCA.

This is a creditor supervised procedure (as opposed to a scheme of arrangement which is a court supervised procedure).

## **Discounted Cash Flow**

A valuation model which takes into account both the time value of money (net present value) and also the total profitability of a project or investment over the life span of that project or investment.

## **EBITDA**

Earnings before interest, tax, depreciation and amortisation.

## **Employee Entitlements**

Entitlements owing to employees of a business including superannuation and leave entitlements which may be afforded certain priorities in the insolvency of that entity.

## **Enterprise Value**

The total value of the business determined by reference to the EBITDA multiple after deducting total debt.

# E

# F

## **FEG**

Fair Entitlements Guarantee is a legislative scheme which provides last resort assistance to eligible employees to cover unpaid employment entitlements if the employee's job is lost due to liquidation or bankruptcy of their employer.

## **Forbearance**

An agreement between the debtor and its major bank creditor/s which imposes a standstill on the bank/s taking further action subject to the debtor meeting certain conditions and obligations set out in the agreement.

## **Fulcrum**

The point at which the value of the business breaks. The fulcrum is critical in a restructuring context as it determines who has control in a restructuring.

# G

## **General Security Agreement**

Formerly referred to as a "fixed and floating charge", a general security interest is a form of security which covers all of the present and after acquired assets and undertaking of an entity to secure that entity's obligations to a secured creditor. The general security agreement must be registered on the Personal Property Securities Register to be enforceable against third parties.

# H

## **Hedging**

Taking steps to protect against or mitigate a risk. Commonly used in futures and foreign exchange markets where parties use facilities available to protect themselves against future price or exchange rate variation.

## **Hive Down/Up**

The transfer of a business, usually either down to a subsidiary company or up to a parent company.

# I

## **Insolvency**

A state where a natural person or corporate entity is unable to pay its debts as and when they fall due and payable.

This is a cash flow test in Australia as opposed to a balance sheet test.

## **Insolvent Trading**

A liability imposed on directors if they allow a company to incur a debt or debts when that company is insolvent. An insolvent trading claim is only available in liquidation. See Safe Harbour (discussed below).

## **Ipsa Facto**

Recent law reform which takes effect from 1 July 2018 and will prevent a counterparty to a contract or agreement with an insolvent entity entered into after 1 July 2018 from exercising a termination right which is based solely on the appointment of a receiver or administrator or the commencement of a scheme of arrangement procedure.

## **Internal Rate of Return (IRR)**

The annual gain realised on an investment expressed as a percentage of capital invested.

## **Junior Debt**

Junior debt is debt which is subordinated (either contractually or structurally subordinated) to the payment of senior debt on the insolvency of the common debtor.

## **Liquidation**

An insolvency procedure commenced either by members (members voluntary liquidation), creditors (creditors voluntary liquidation) or by the court (court liquidation) which results in a liquidator being appointed to the company to realise any assets of that entity, to repay (to the extent possible) any liabilities of the company and to wind down the company's affairs. A company may also be placed into liquidation via voluntary administration in circumstances where no deed of company arrangement is proposed and the creditors are left with no other option.

Liquidation is a terminal procedure and ultimately results in the company being deregistered.

A liquidator has a number of statutory powers which are not available to administrators or receivers which allow the liquidator to pursue directors for insolvent trading and creditors for voidable transactions (such as unfair preference claims discussed below) entered into by the company in the period leading up to the liquidator's appointment.





### **Loan to Own**

A loan to own transaction involves a party acquiring a secured debt position in a target company in order to influence control and ultimately acquire ownership of the target company and its assets/business.

### **Lock-Up Agreement**

Although not common in Australia, lock up agreements feature heavily in UK and European restructurings and are an agreement where the company's creditors commit themselves in advance to act in a certain manner (for example, vote in favour of a scheme of arrangement) during the restructuring. Often the agreement prevents the creditor from trading its debt unless the purchaser of the debt agrees to be bound by the lock up. Lock up agreements are a useful tool and provide certainty to ensure that a restructuring can be delivered.

### **LVR**

Loan to Value Ratio which is the amount an entity is borrowing represented as a percentage of the value of the property being used as security for that loan.



### **Mezzanine Debt**

A layer of finance between senior debt and equity which ranks behind senior debt in the event of the insolvency of the company. Often with an interest rate which is higher than that paid on senior debt (which reflects the increased risk).

### **Moratorium**

A moratorium comes into effect from the commencement of a voluntary administration process to give the company breathing space to determine what its options are. The moratorium prevents creditors from taking actions or proceedings against the company or its property during the administration period without the administrator's written consent or leave of the court. The moratorium also extends to owners and lessors of property used, occupied by or in the possession of the company including landlords of premises leased by the company.



### **Non-circulating asset**

Historically referred to as "fixed charge" assets, non-circulating assets are tangible assets such as plant and equipment.



## **Option**

A type of derivative. It is a contract giving the holder the right but not the obligation to buy or sell an underlying asset at a specified price during a given period of time.

## **Phoenix Company**

A company which emerges from the collapse of another entity and takes over the failed or insolvent business of an earlier company.

## **Planned Insolvency**

There is a distinction to be drawn between a typical pre-pack transaction and a planned insolvency where the parties use a formal insolvency method to implement a broader restructuring in circumstances where a fully consensual restructuring is unable to be achieved. The formal insolvency process is used to cram down dissenting creditors to deliver the restructuring. This technique is commonly used in the United Kingdom (along with traditional pre-packs) where achieving a fully consensual restructuring is not possible. In these circumstances, the pre-insolvency planning is critical to working up any non-consensual Plan B strategy.

## **Pre-Pack**

A sale of some or all of a company's assets which is arranged prior to, and completed shortly after, a formal insolvency appointment. In most instances, it is completed without any approval or involvement of the creditors and the counter-party to the pre-pack transaction is known at the time of the formal insolvency. Pre-packs are often used in transactions which involve companies whose businesses are reliant on people or goodwill and are intended to preserve the value in these businesses which would otherwise fall away in a protracted insolvency procedure. Historically, the use of pre-pack transactions in Australia has been limited but it is common in the United Kingdom.

## **Proof of Debt**

A statutory form to be completed by a creditor of a company in administration or liquidation under which a creditor proves the debt owed by that entity to it. This is a necessary step to take if the creditor wishes to attend and vote at any meeting of creditors of the insolvent company.

Secured creditors should approach the proof of debt process with caution.

# R

## Receivership

A procedure available only to a secured creditor (following a default by the debtor) to appoint a receiver to take control of the secured assets of a company. The receiver's primary duty is to realise the secured assets for the benefit of the secured creditor (as opposed to an administrator or liquidator who has a duty to unsecured creditors also). A receiver can also be appointed by the court (court appointed receivership).

A receiver can be appointed under a general security agreement over all of the assets and undertaking of a company, over part of the company's property under a specific security agreement or over the company's real property pursuant to a mortgage.

# S

## Safe Harbour

Introduced into Australia on 18 September 2017, safe harbour is an exception to the insolvent trading regime (discussed above) available to directors of companies trading in the twilight zone if the directors are actively pursuing a restructuring or turnaround plan.

A director will enter safe harbour once the director starts to suspect the company may become or be insolvent and starts to develop one or more courses of action reasonably likely to lead to a better outcome for the company in comparison to an immediate liquidation or administration.

To qualify for safe harbour, the company must be compliant with its statutory tax obligations and up to date with its employee entitlement obligations.

## Scheme of Arrangement

A scheme of arrangement is a flexible and long-established Corporations Act procedure which can be used to vary the rights of some or all of a company's creditors and/or shareholders. This procedure is available to solvent and insolvent companies as there is no minimum level of financial distress required (as opposed to voluntary administration). It is a court supervised procedure which involves:

- An initial application to the court to obtain an order to convene the necessary meetings of the various classes proposed under the scheme
- The convening of each of the class meetings (where it is necessary for 75% in value and 50% in number of each class to vote in favour of the scheme)



- A further application to the court seeking the court's sanction to the scheme (often referred to as the "fairness hearing").

### **Set-Off**

Insolvency set-off – generally in the context of liquidation, section 553C of the Corporations Act operates automatically to set-off mutual credits, debts or other mutual dealings so that only the balance of an account is admissible to proof against the insolvent company or is payable to the insolvent company (as the case may be).

### **Statutory Demand**

A demand for payment of a debt which is due and payable made under the *Corporations Act 2001* which requires payment within 21 days or the creditor is entitled to make application to the court to wind up the debtor.

### **Trust**

An arrangement whereby an asset is held by a person or persons (the trustees) for the benefit of some other person or persons (the beneficiaries).

### **Unfair Preference**

A payment made by an insolvent entity to an unsecured creditor in the 6 month period prior to the appointment of the insolvency practitioner (or in the 4 year period if a related party is involved) which results in that creditor receiving more than it would have in the winding up of that entity.

An unfair preference claim is only available if a company is in liquidation (as opposed to administration, subject to a DoCA or in receivership).

### **Uncommercial Transaction**

A transaction entered into by a company where it may be expected that a reasonable person in the company's position would not have entered into the transaction having regard to the benefit and detriment to the company of the transaction and the respective benefits of the other parties to the transaction.

An uncommercial transaction claim is only available in liquidation.



# V

## **Voluntary Administration**

The voluntary administration procedure is Australia's "turnaround and rescue procedure" where the primary objective is to maximise the chances of the company continuing in existence. It involves the appointment of an administrator who takes control of the company and manages its affairs until the creditors determine the fate of the company at the second creditors meeting.

Voluntary administration can be initiated by the directors (having resolved that the company is insolvent), a secured creditor holding security over all or substantially all of the assets of the company (where the secured creditor is entitled to enforce that security) or by a liquidator.

The creditors of a company vote on three possible outcomes of the voluntary administration procedure:

- the administration should end and the company be returned to the control of the directors; or
- the company should execute a deed of company arrangement; or
- the company should be wound up.

# W

## **Warrants**

Rights of conversion into a stated amount of company's shares. Frequently attached to mezzanine finance. Sometimes referred to as equity kickers.

## **Winding Up**

An alternative term for liquidation.

## **Work Out**

A private agreement between a debtor or a corporate group in financial difficulties, and its creditors – mainly banks but sometimes including bondholders. The primary objective of a workout is to save the company or corporate group privately and to avoid the need for an insolvency procedure which is likely to be value destructive.

# Y

## **Yield**

A term used to describe the return on an investment over a particular period of time. It refers to the interest or dividend earned on debt or equity.

## **Zombie Company**

A company which is under-performing but is generating just enough cash to service the interest component of its debt but not to repay principal or to invest in further development.

In an environment of relatively cheap credit, the number of zombie companies in the economy tends to increase.



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