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(Australia) Debt Ceilings Apply Outside of the US

Article By:

Masi Zaki

Kate Spratt

With increased stress in global, domestic, and regional economies, the number of Australian businesses at risk of bankruptcy is approaching a three-year high.

The uncertainty in markets is impacted by a number of issues, including monetary policy, supply chain challenges, labour market constraints, increased creditor activities and a balance sheet reckoning post the COVID-19 world where government support propped up unworthy businesses. That potentially debilitating economic cocktail is compounded by the fact that all entities have a debt ceiling, whether they recognise it or not. That is, their capacity to draw on debt to continue as going concerns is dependent on the extent to which, firstly, their boards are prepared to take on new debt and, secondly, whether their lenders are prepared to extend terms and facilities.

A Statutory Presumption

If a company is unable to pay its debts as and when they fall due but fails to appoint external administrators, creditors are able to wind up the entity on the presumption of insolvency.1 This allows an external administrator to take control of the entity, seek to preserve and realise any assets, and to better protect the interests of creditors (as opposed to, say, shareholders or directors). However, the process usually takes a set statutory period in order to trigger the presumption and, even then, the final outcome is far from certain. Where the distress of a corporation is evident (although no presumption has arisen) and there is risk that if urgent action is not taken, the value of assets available to creditors may be significantly diminished or compromised, then urgent recourse may be taken.

There may be situations where an entity has significant value in assets, and insufficient evidence is available to determine whether it is in actual or technical insolvency, and creditors or shareholders have lost trust and confidence in management and the directors. In these situations, creditors or shareholders concerned about, firstly, preserving value, and, secondly, ensuring control is taken by appropriately qualified persons, may seek urgent interim or final relief from a court.

Appointing External Controllers

Creditors and shareholders have standing under the Corporations Act to seek for a company to be wound up on just and equitable grounds. It can be, but is not always, a quicker and more effective path to taking control, but, as with any compulsive court process, there are upside and downside risks which need to be carefully assessed before proceeding.

The power conferred upon the court to wind up an entity is broad, the potential classes of conduct that justify the court invoking its power are not closed and it ultimately depends on the facts and circumstances of a particular case.2 In determining whether to invoke the power to wind up an entity on just and equitable grounds, the court must be satisfied that the applicant has sufficient standing and there is no other alternative and adequate remedy available.3 “Another remedy available” has been interpreted broadly by the courts and is not confined to a cause in action, but rather a course of action available to a party.4

A creditor may wish to seek urgent relief of the court to have an entity wound up and to have external administrators take control. The circumstances that may give rise to a creditor or shareholder taking this step may be where concerns are held over the

a. Management of a company

b.Potential dissipation of assets

c. Insolvency of an entity

A just and equitable winding up removes the need to rely on the presumption of insolvency and allows shareholders or creditors to take urgent steps to preserve any remaining assets in a company. However, it is not without risk (or exposure to damages claims).

Another option available to creditors or shareholders is to apply to seek for a receiver to be appointed for a limited purpose, such as to realise a particular asset or class of assets, to adjudicate on competing claims and to distribute dividends.

The court holds the power to appoint receivers if it considers it convenient to do so. That power is not confined to a closed class of circumstances, but the court will generally invoke its jurisdiction to protect or preserve property for those who have an interest in it.5 This is a further path open to creditors or shareholders seeking urgent relief from the court where concerns are held over the insolvency of an entity, management or potential dissipation of assets. The power and ambit of a receivership appointment and property to be realised is dictated by the orders of the court.

The limited appointment may be preferable to external controllers, creditors, and the court in its oversight capacity. The appointees are provided with a clear set of duties and responsibilities that are generally limited to allowing them to undertake the necessary steps to realise and distribute the proceeds of a particular asset or class of assets. Their powers and duties generally do not extend to extensive reporting and investigation obligations, as might be seen in a traditional liquidation sense. In circumstances where there are competing interests, limited receivership appointments provide certainty as to the adjudication and treatment of those interests and the distribution processes.

Most Debt Ceilings Cannot Be Increased by Internal Negotiations

Unlike the debt ceiling that applies to the US government, private companies do not have the luxury

of engaging in internal negotiations and then agreeing to increase their own debt ceilings. And so, with uncertainties remaining in many markets, creditors (not limited to lenders) need to take care to implement robust facility and payment terms, and to monitor performance and compliance. When trust and confidence is lost in the management of an entity, or concerns about its potential insolvency or dissipation of assets arise, urgent steps must be taken to preserve asset values and maximise potential returns. The ambit of circumstances in which the court's jurisdiction to trigger the appointment of external controllers is unconfined. However, the court's jurisdiction will only be involved on robust applications brought by creditors acting decisively and having appropriately assessed their risk profile.

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1 See s459A and 459P of the Corporations Act 2001 (Cth) (Corporations Act).

2 Australian Securities and Investments Commission v ActiveSuper Pty Ltd (No 2) [2013] FCA 234.

3 See 467(4) of the Corporations Act.

4 Host-Plus Pty Ltd v Australian Hotels Association [2003] VSC 145; MF Lady Pty Ltd (Trustee)

5 Sapphire (SA) Pty Ltd v Ewens Glen Pty Ltd [2011] FCA 600.

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