CLASS WARFARE IN DEBT RESTRUCTURING: DOES AUSTRALIA NEED CROSS-CLASS CRAM DOWN FOR CREDITORS' SCHEMES OF ARRANGEMENT?

JASON HARRIS*

I INTRODUCTION

The corporate insolvency landscape is changing. While the numbers of formal insolvency appointments have not increased dramatically since the Global Financial Crisis,[1] the dialogue surrounding financial distress and the methods to address it have moved away from formal insolvency appointments to restructuring and turnaround before financial distress becomes insolvency.[2] Insolvency proceedings, such as receivership, liquidation and even voluntary administration (which has a stated purpose of trying to save businesses)[3] carry a stigma of failure,[4] which makes trading on as a business more difficult and reduces creditor confidence in the potential to save the business through a formal restructuring.

Schemes of arrangement have been used to restructure companies for more than 160 years.[5] A scheme may be used by creditors to address financial distress, and offers numerous advantages over other formal mechanisms (such as liquidation and voluntary administration) because it applies to secured creditors[6] and can be used to bind dissenting minorities of both secured and unsecured creditors.[7]

The ability to bind minorities within a specific class of creditors or members is sometimes referred to as a 'cram down'. A creditors' scheme of arrangement may be proposed between a company and one or more classes of creditors. Where the scheme targets multiple classes of creditors it must be approved by a majority of each class. If one class of creditors dissents, then the scheme fails. The ability of a majority of creditor classes to bind one or more dissenting *classes* is referred to as 'cross-class cram down' and is the focus of this article.

Creditors' schemes of arrangements are often criticised as being slow, costly, and cumbersome. One of the issues that presents difficulties for using schemes for restructuring is the requirement to compose separate classes of creditors, and the need

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1 See further <http://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/ >.

2 See ARITA, *A Platform for Recovery*, 2014 (available from <www.arita.com.au>); Economics References Committee, Senate, *Performance of the ASIC* (2014) Rec 61; Productivity Commission, 'Business Set-Up, Transfer and Closure' (Report No 75, 30 September 2015) Ch 13, 14.

3 *Corporations Act 2001* (Cth) s 435A.

4 Productivity Commission, 'Business Set-Up, Transfer and Closure' (Report No 75, 30 September 2015) Ch 13 (in particular Finding 13.1).

5 Colin Anderson, 'Finding the Background of Part 5.3A of the Corporations Law' (1999) 10 *Australian Journal of Corporate Law* 107; Jennifer Payne, *Schemes of Arrangement: Theory, Structure and Operation* (2014) [1.2].

6 See for example *Re Nine Entertainment Group Ltd* [2012] FCA 1464; (2012) 211 FCR 439.

7 *Corporations Act 2001* (Cth) s 411(4).

to obtain approval from each class, which may create opportunities for greenmailing[8] lenders which can result in value leakage to subordinate creditors. This contrasts with the cross-class 'cram down' mechanism in the United States that allows for a court order to bind dissenting classes to a restructuring plan. Cram down mechanisms have been introduced or proposed in several jurisdictions in recent years, including Singapore and England. This article argues that Australian scheme laws would benefit from a cross-class cram down mechanism to facilitate debt restructuring.

The current law requires creditors to be put into separate classes for voting, in certain circumstances, as discussed below in Part IV. The potential for class hold outs can allow specific creditors to engage in greenmailing by threatening to vote against the scheme in the hope of a better deal for themselves by receiving a payment or equity stake in the restructured entity. In response, the scheme proponent may seek to establish that the enterprise value puts the dissenting class underwater,[9] at least on a liquidation analysis, which may lead to complex arguments in scheme litigation concerning the appropriate enterprise value and where the break in the capital structure is.[10] The greenmailing potential of junior class hold-outs can also result in value leakage from senior lenders to junior creditors and encourage debt traders to buy into strategic stakes to hold senior lenders hostage in order to extract value from the restructuring, perhaps at the risk of inhibiting the restructuring if further value is not provided. While some may argue that this is simply the operation of the market for corporate debt, if it entrenches inefficiencies and increases costs and delays it may result in viable businesses not being able to restructure using a scheme and the business potentially failing.

This article will argue that these complexities, which reduce the efficiency of creditors' schemes as a debt restructuring tool, could be addressed by introducing a cross-class cram down mechanism into Australian law. A cross-class cram down mechanism would allow the court to address rent-seeking behaviour,[11] which is often seen in debt trading around restructuring efforts, while still upholding the majority views of the creditors. Furthermore, introducing such a cram down mechanism would bring Australian creditors' schemes into line with restructuring tools in other major jurisdictions such as the US, several European countries, China, Japan and, most recently, Singapore. Australia is in a global competition for restructuring capital, and providing an effective and efficient restructuring procedure will make Australia a more attractive forum in which to pursue restructuring.

Part II of this article explains the role and benefits of debt restructuring using creditors' schemes of arrangement. Part III considers the operation and scope of

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8 Greenmailing refers to the practice of acquiring a strategic stake in a company's debt or equity with the goal of pressuring the majority holder to acquire the stake at more than market value. For a discussion of greenmailing see generally: *Re Elders Australia Ltd; Super John Pty Ltd v Futuris Rural Pty Ltd* [1998] FCA 1377.

9 A tier in the company's capital structure is said to be underwater where it has no economic value on a liquidation analysis because the company's assets are insufficient to pay all debts and the priority contest between classes of creditors (both secured and unsecured) will leave that class with a nil return.

10 The phrase 'break in the capital structure' refers to the layer of the capital structure (that is the layers of debt and equity in a company) where there will be an inability to pay in full. If the break occurs in the mezzanine debt that means that holders of mezzanine debt (usually in the form of notes) will not be paid in full.

11 Rent-seeking is an economic term that refers to a person seeking to extract economic returns in excess of their own deployment of capital or personal exertion. Its colloquial use refers to seeking unjustified economic returns. See generally, Anne Krueger, 'The Political Economy of the Rent-Seeking Society' (1974) 64 *American Economic Review* 291.

creditors' schemes. Part IV examines class composition in creditors' schemes. Parts V and VI argue for the introduction of a cross-class cram down mechanism into Australian law as a way of facilitating debt restructuring and corporate rescue. Part VII concludes the article.

In order to understand the value that effective creditors' schemes can play as a formal restructuring tool it is important that we clarify, in brief, what debt restructuring is.

II Debt Restructuring

A *What is debt restructuring?*

When viable businesses get into financial distress their management and advisors will look for restructuring mechanisms that can address their financial difficulties while allowing the business to continue operating so that the value of the entire enterprise can be maximized. The *Corporations Act 2001* (Cth) offers a range of formal restructuring tools,[12] including voluntary administration followed by a deed of company arrangement; [13] liquidator compromises with creditors; [14] and creditors' schemes of arrangement.[15] Each of these statutory tools addresses classes of creditors differently.[16]

Voluntary administration does not distinguish between different creditor classes for voting purposes,[17] although secured creditors maintain their enforcement rights and usually abstain from voting on a deed proposal, so as to preserve those rights.[18] Liquidator compromises cannot restrict secured creditor rights[19] and in some cases (applying s 477(1)(c) of the *Corporations Act*) cannot bind dissenting unsecured creditors.[20]

The inability to restrict or remove enforcement rights of secured creditors is a major limitation on voluntary administration as a tool to restructure large businesses that often have several classes of secured debt at varying levels of priority (such as senior, junior and mezzanine debt)[21] in addition to groups of unsecured creditors.[22]

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[12] It is important to distinguish informal restructuring, otherwise known as a workout, which is based on contractual consent with creditors and relies on no formal appointment under the *Corporations Act*.

[13] *Corporations Act 2001* (Cth) Pt 5.3A.

[14] *Corporations Act 2001* (Cth) s 477(1)(c) (for court liquidations); s 510 (for voluntary liquidations).

[15] *Corporations Act 2001* (Cth) s 411.

[16] For a discussion of the meaning of the term creditor under different provisions see: William Koeck and Ian Ramsay, 'The Importance of Distinguishing Between Different Categories of Creditors for the Purposes of Company Law' (1994) 12 *Company & Securities Law Journal* 105.

[17] *Lehman Brothers Holdings Inc v City of Swan* [2010] HCA 11, [30]; (2010) 240 CLR 509; *DSG Holdings Australia Pty Ltd v Helenic Pty Ltd* [2014] NSWCA 96; (2014) 86 NSWLR 293.

[18] *Corporations Act 2001* (Cth) s 444D; *Australian Gypsum Industries Pty Ltd v Dalesun Holdings Pty Ltd* [2015] WASCA 95; (2015) 106 ACSR 79; *Re Bluenergy Group Ltd (subject to DOCA) (Admin Appt)* [2015] NSWSC 977; (2015) 107 ACSR 373.

[19] This is because liquidator powers only cover the 'property of the company' (see *Corporations Act 2001* (Cth) s 477) and therefore do not cover a creditor's rights *in rem*.

[20] *Re Switch Telecommunications Pty Ltd (in liq); Ex parte Sherman* [2000] NSWSC 794; (2000) 35 ACSR 172.

[21] For a discussion of different levels of corporate debt see King and Wood Mallesons, *Australian Finance Law* (7th ed, 2016) Part III; Geoffrey Fuller, *Corporate Borrowing: Law and Practice* (5th ed, 2016).

Schemes of arrangement can be used to bind one or more dissenting secured creditors, which is a significant advantage over voluntary administration and liquidator compromises, particularly where there is an attempt to recapitalize a business in financial distress, but a minority of secured creditors hold out. Restructuring using a scheme has the goal of saving all or at least some of the company's business, thus preserving enterprise value, as well as jobs, supplier and customer contracts and government tax receipts through continued trading.

In recent years, creditors' schemes have been used to restructure several large and often complex businesses such as Centro, Nine Entertainment, Atlas Iron, Emeco, and Boart Longyear. While this indicates that schemes are clearly useful, it should be noted that in each of these restructurings, disputes around the composition of classes were one of the issues that needed extensive negotiation and court determinations. In the author's view, a cross-class cram down mechanism would have made the restructuring efforts easier and more efficient. The lack of a cross-class cram down mechanism (compared with other jurisdictions such as the United States) could encourage debt traders to buy up strategic blocking stakes to extract further value from the scheme proponents, which could make restructuring more difficult to achieve and costlier to implement.

Restructuring is a means to address financial distress in a business, rather than saving businesses that are fundamentally uneconomic. A business may be financially distressed for a variety of reasons, including poor management quality, poor cost controls and internal information systems, employee fraud or theft, poor economic trading conditions or changes in customer preferences.[23] A company's capital structure may need repair where it takes on too much debt compared with its current and forecast cash flows.[24] A company's balance sheet problems can be addressed by reducing debt and freeing up cash to maintain operations and provide for capital expenditure. Restructuring will usually involve operational changes (such as improving information flows and accountability, cost reductions, improving product or service offerings and refocusing management strategy) and financial elements (including asset sales, inventory and cash management, refinancing and issuing equity). This article is concerned with using formal legal tools to implement a financial restructuring to address financial distress.

A financial restructuring (hereafter 'restructuring')[25] may involve recapitalizing the business by removing levels in the capital structure that hold no economic value. Where the company is insolvent, and hence equity has no economic value, this can involve removing the existing equity holders by the use of a 'debt for equity swap'.[26] Some, or all, of the creditors, usually secured creditors, will swap some, or all, of their debt for newly issued equity in the company and this will reduce the company's existing debt burden and fix the balance sheet with a reduced level of debt that is usually on longer payment terms to give the business time to implement the operational elements of the restructure.

It is also possible to restructure the business by transferring the assets to a new

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[22] There is a limited ability to obtain a court order limiting the rights of certain secured creditors, owners or lessors during a deed of company arrangement: s 444F.

[23] See further ASIC, *Insolvency Statistics: Series 3.3*, December 2016 Table 3.3.6 (reporting on causes of company failure by external administrators) <http://asic.gov.au/regulatory-resources/find-a-document/statistics/insolvency-statistics/insolvency-statistics-series-3-external-administrator-reports/#3.3>.

[24] For a discussion of cash flows see AASB, *AASB 107: Statement of Cash Flows*, (August 2015).

[25] This is sometimes called a 'balance sheet restructuring'.

[26] For a discussion of debt for equity swaps see: Karl Clowry, 'Debt-for-equity swaps' in Ben Larkin (ed), *Restructuring and Workouts* (2nd ed, 2013) Ch 3.

company, where the continuing secured creditors take equity in the new entity. Creditors who will not be participating in the restructuring, and whose claims have little value in liquidation, are typically left behind in the existing company and then wound up. This can be distinguished from improper phoenix activity because the transaction is reviewed and sanctioned by the courts with all affected parties having the opportunity to be heard.

One key element to restructuring financially distressed businesses is to target where the value breaks in the capital structure. Many companies (even small and medium enterprises) have multiple layers of secured debt from loans to banks covered by security over the entire business, to equipment finance, and debtor finance facilities.[27] In large companies, it is common to also have bonds issued in layers (called tranches) to various (usually professional and institutional) investors with different levels of priority and interest.[28] Large businesses also commonly have group loans at the most senior level in the capital structure (known as 'senior secured facilities'). These may be constituted by a syndicated loan facility with multiple banks and institutional financiers as participants or may involve multiple bi-lateral facilities on similar terms (known as club loans) or a mixture of both.[29]

When a company becomes financially distressed it is common for some of the secured lenders to sell their debts to distressed debt and special situation funds (sometimes called vulture funds) that buy up the debt at a fraction of its face value (such as 60c on the dollar).[30] This may result in fragmentation of one or more levels of secured debt as original lenders (known as par lenders) sell out portions of their debt to various funds looking to restructure (in order to recover the par value of the debts) or at least to obtain a higher return than their purchase price.[31] The debt traders who buy up par lender debt may have very different motivations from the original par lenders, who may be domestic banks and institutional investors that have existing relationships with the corporate debtor beyond the loan facility (such as superannuation, transactional banking and investment banking services). Debt traders and special situation funds are often domiciled overseas, although an increasing number of international funds are setting up Australian branch offices.[32]

The complexity of modern corporate debt capital structures, with multiple levels of secured debt, and the fragmentation of those structures (through debt trading) during restructuring efforts, can make it difficult, and in some cases impossible, to obtain the

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27 Debtor finance refers to invoice discounting and factoring arrangements based on the debtor's receivables: see further Jamie Ng and Emanuel Poulos, 'Chapter 4.2 Receivables Financing' in Craig Wappett, Bruce Whittaker and Steve Edwards (eds) *Personal Property Securities Law in Australia* (2010). For a discussion of the varieties of corporate finance see King and Wood Mallesons, *Australian Finance Law* (7th ed, 2016) Part III.

28 Under the *Corporations Act 2001* (Cth), the commercial term 'bonds' are referred to as either debentures (which are secured) or 'notes' (which are unsecured): see Ch 2L. See further Robert Austin and Ian Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (16th ed, 2015) Ch 19.

29 See King and Wood Mallesons, *Australian Finance Law* (7th ed, 2016) Ch 11; LexisNexis, *Australian Corporate Finance Law*, Ch 3.

30 See Adam Watterson, 'Pulling back the shades: demystifying vulture funds' (2016) 27 *Journal of Banking and Finance Law and Practice* 131; William Stefanidis, 'Reviving the Incentive to Compromise in Corporate Restructuring: The Role of Secondary Debt Markets' (2017) 28 *Journal of Banking and Finance Law and Practice* 135; Lionel Meehan, 'Recent trends in restructurings involving distressed debt trades and "loan to own" strategies' (2013) 14 *Insolvency Law Bulletin* 27.

31 See further Christian Pilkington, *Schemes of Arrangement in Corporate Restructuring* (2013) Ch 2.

32 See for example Oaktree and Bain Capital Credit.

consent of all classes of secured creditors. Furthermore, some debt funds may have taken out a form of debt insurance known as a credit default swap which will pay out if the restructuring fails, which creates a strong economic incentive to hinder restructuring efforts in favour of liquidation.[33] If these creditors can establish that a separate class is needed for their votes, then this gives them effective leverage to greenmail the senior lenders into diverting value to their level in the capital structure to ensure that all classes of creditors approve the scheme. Their goal may not be to try to save the business through a restructuring agreement, but simply to extract value by threatening the restructuring effort which increases costs and delays and may jeopardize the rescue of the business.

B *The benefits of schemes for debt restructuring*

Schemes of arrangement offer several benefits as a corporate debt restructuring tool. First and foremost, schemes are extremely flexible as to how they are to affect the relationship between debtors and creditors. The *Corporations Regulations* provide for certain information to be provided to creditors regarding the nature of the scheme;[34] there are no mandatory prescribed provisions that must be included within a scheme of arrangement, which leaves it to the company and its creditors to formulate a scheme proposal that will satisfy both of their essential needs. However, the requirement to have all creditor classes approve the scheme leaves the scheme open to hold-out classes.

Creditors' schemes are commonly used to impose a moratorium on claims enforcement and/or cancel debts and to compromise existing liabilities, but their use can extend to:

- Amend and extend existing financing facilities;[35]
- Reset loan covenants;[36]
- Change the priority of creditor classes by allowing for certain debts (such as those provided to assist with the restructuring) to be given priority over existing debt classes (provided each of the affected classes approve of the scheme);[37]
- Undertake a debt swap, debt/asset swap or a debt/equity swap;[38]
- Transfer obligations to a new company (for example by way of a swap of existing debt, which is cancelled or diluted, for debt issued by the new company);[39]
- Restructure stapled securities.[40]

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33 See further, INSOL International, *Credit Derivatives in Restructuring* (INSOL, 2006); Jeremy Green, 'The Impact of Credit Derivatives on Corporate Debt Restructuring' (2008) 19 *Journal of Banking and Finance Law and Practice* 97.

34 *Corporations Act 2001* (Cth) s 411(3)(b); *Corporations Regulations 2001* (Cth) reg 5.1.01, Sch 8.

35 *Cortefiel SA v Mep 11.S.A.R.L.* [2012] EWHC 2998 (Ch); *Re Stemcor (S.E.A.) Pty Ltd and Stemcor Trade Finance Ltd* [2014] EWHC 1096.

36 *Cortefiel SA v Mep 11.S.A.R.L.* [2012] EWHC 2998 (Ch).

37 *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch).

38 *Re Telewest Communications Plc* [2004] EWHC 924; *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch); *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch).

39 *Re Mytravel Group Plc* [2004] EWHC 2741 (Ch); *Primacom Holding GmbH v Credit Agricole* [2011] EWHC 3746 (Ch); *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch).

40 *Re Centro Properties Ltd* [2011] NSWSC 1465; (2011) 86 ACSR 584.

The ability to swap debt for equity in a company (or a new company that has received the debtor company's assets through a transfer) has been particularly popular with distressed debt investors who can use schemes of arrangement as part of a 'loan to own' strategy to take over financially distressed businesses. Schemes provide exemptions from prospectus requirements under Ch 6D of the *Corporations Act*,[41] and are also exempt from the 20% takeover prohibition regulation.[42]

Aside from advantages for creditors pursuing a 'loan to own' strategy, schemes offer advantages for incumbent managers as they are largely a debtor in possession process, with management able to drive negotiations with key creditors.[43]

Importantly, as the company does not need to be insolvent to use a scheme it may not trigger automatic termination clauses in key contracts (such as asset management agreements, leases and supply agreements), which will usually allow for termination upon the commencement of formal insolvency proceedings such as the appointment of a liquidator, receiver or voluntary administrator.[44] These contracts may also contain a change of control provision that allows for review, acceleration, or termination, but a scheme can be organized at the holding company level so that operational subsidiaries that have entered into service and supply contracts are not affected by a change in control. Indeed, the purpose of the scheme may be to transfer debt from an overleveraged operating subsidiary to a holding company so that the operating subsidiary is better able to continue trading without the threat of insolvency or loan covenant breaches.

Secured creditors would normally constitute a separate class of creditors, although where a company is insolvent or close to insolvency it may be that only the secured lenders (or indeed only a tranche of secured lenders) will receive any distribution from the scheme and so the secured lenders may be a single class on their own or may be broken into separate classes of secured creditors (such as senior and junior secured classes).

Multi-party loan facility agreements may require more than 75% approval from participants in the facility in order to amend the terms of the agreement. The growth in secondary debt trading in Australia means that it is common for there to be a fragmentation in the secured creditor numbers so that obtaining consent for loan facility variations/waivers etc may be difficult.[45] A scheme is well suited to dealing with such circumstances assuming that the requisite majority of 75% in value and majority in number can be obtained (which is still likely to be lower than approval requirements in syndicated loan documents).[46] The ability to bind secured creditors to a scheme may assist in encouraging a consensual workout between the stakeholders. For example, the restructuring of Fitness First involved a scheme being originally proposed to address problematic leasing contracts held by dissenting landlords. However, the scheme was not proceeded with as a consensual arrangement was obtained following

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41 *Corporations Act 2001* (Cth) s 411(17). Similar relief is granted for deeds of company arrangement arising after a period of voluntary administration: ibid s 411(17A).

42 *Corporations Act 2001* (Cth) s 611 (item 17).

43 A scheme administrator may be appointed under the terms of the scheme: *Corporations Act 2001* (Cth) s 411(9).

44 In Australia, there is no protection in corporate insolvency against the termination of executory contracts in the same manner as the US Bankruptcy Code provides in §365. There is however protection for personal insolvency: see *Bankruptcy Act 1966* (Cth) s 301. On 1 June 2017, the *Treasury Laws Amendment (2017 Enterprise Incentives No. 1) Bill 2017* (Cth) was introduced into Parliament with a proposal to introduce protection against *ipso facto* clauses for receivership, voluntary administration, and schemes of arrangement.

45 See further Pilkington, above n 31.

46 Ibid.

the threat of the scheme bringing home to the dissenting creditors what their likely position would be if a scheme was implemented.

Schemes also offer the advantage in restructuring that they need not involve *pari passu* payment to creditors.[47] Schemes may also depart from the system of priority payments that arise in liquidation, although the comparison for companies that are insolvent or likely to become insolvent will be with outcomes in a liquidation and so while priority may be changed, the creditors covered by the scheme should be paid at least as much as they would be likely to receive in the absence of a scheme (ie if the company went into liquidation).

Schemes can also include mandated releases from scheme creditors for rights that they may have against third parties, provided that there is a sufficient nexus between the release and the relationship of debtor/creditor,[48] which is not possible under a voluntary administration followed by a deed of company arrangement.[49]

As demonstrated above, creditors' schemes offer a range of benefits for implementing effective debt restructuring for companies in financial distress over other options in administration and liquidation. In the next Part, I examine the operation of the scheme provisions in the *Corporations Act*, as a foundation for a critical examination of the class composition issue in Part IV.

III The Operation of Creditors' Schemes

Australian schemes of arrangement are regulated by s 411 of the *Corporations Act*, which appears in Pt 5.1 of Ch 5 (External Administration). A scheme can only be used by a 'Part 5.1 body',[50] which is defined as a company or a 'registrable body' that is registered under Divs 1 or 2 of Part 5B.2 of the Corporations Act.[51] In short, schemes of arrangement are available for companies and bodies corporate that are registered under the Corporations Act.[52] This is in contrast to the position in England, where schemes of arrangement are becoming an increasingly popular tool for foreign companies that are not registered in England but have finance contracts that are governed by English law or which select English court jurisdiction.[53]

Where the jurisdiction to consider the scheme is enlivened, the scheme must also involve a 'compromise or arrangement' that is 'between the body and its creditors or any class of them'.[54] The term compromise has been described as involving some give and take where both parties make concessions and give up something.[55] A compromise

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47 *Fowler v Lindholm* [2009] FCAFC 125, [78]; (2009) 178 FCR 563; *Re Trix* [1970] 3 All ER 397; *Re Austcorp Tiles Pty Ltd* (1991) 10 ACLC 62; *Re Hawk Insurance Co Ltd* [2001] 2 BCLC 480, [15].

48 *Fowler v Lindholm* [2009] FCAFC 125; (2009) 178 FCR 563.

49 *Lehman Brothers Holdings Inc v City of Swan* [2010] HCA 11; (2010) 240 CLR 509; Jason Harris, 'Adjusting Creditor Rights Against Third Parties During Debt Restructuring' (2011) 19 *Insolvency Law Journal* 22.

50 *Corporations Act 2001* (Cth) ss 9 (definition), 411(1).

51 *Corporations Act 2001* (Cth) s 9. A company is itself defined as a 'company registered under the Corporations Act': ibid s 9.

52 See further the explanation of the historical development of the phrase 'Part 5.1 body' in Tony Damian and Andrew Rich, *Schemes, Takeovers and Himalayan Peaks* (3rd ed, 2013) [3.1.5].

53 See Pilkington, above n 31, Ch 2; Payne, above n 5, Ch 7.

54 *Corporations Act 2001* (Cth) s 411(1).

55 *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213, 228 per North J.

does not involve the majority forcing the minority to give a gift to them.[56] A total surrender or confiscation of rights for nothing in return would not be a compromise.[57] A compromise involves the resolution of some dispute about rights.[58] The term arrangement is broader than a compromise,[59] because it does not need to involve the resolution of a dispute between the parties,[60] but still involves the concept of give and take by both parties.[61]

The terms compromise and arrangement are to be construed liberally.[62] As Lowe ACJ said in the often-cited decision in *Re International Harvester*: 'almost any arrangement otherwise legal which touches or concerns the rights and obligations of the company or its members or creditors may be come to under [the predecessor to s 411]'.[63]

Schemes therefore offer a flexible tool for restructuring businesses that can be shaped to the circumstances through negotiation with the major creditors, although not to circumvent another provision in the *Corporations Act*.[64]

The scheme provisions apply to creditors, including both secured and unsecured creditors.[65] A creditor for this purpose is one who has a pecuniary claim against the company, including prospective and contingent claims as well as claims in the nature of unliquidated damages.[66] There may be particular difficulties in identifying who the relevant creditor is where the debt involves debentures or notes.[67] It is possible that the creditor is the trustee who holds the instruments on behalf of investors,[68] although more recently it has been held that the ultimate beneficial owners of bonds were the relevant creditors for voting purposes.[69]

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56 *Mercantile Investment and General Trust Co v International Co of Mexico* [1893] 1 Ch 484, 489 per Lindley LJ; *Re NFU Development Trust Ltd* [1973] 1 All ER 135.

57 *Re T&N Ltd* [2006] EWHC 1447 (Ch), [50] per Richards J.

58 *Mercantile Investment and General Trust Co v International Co of Mexico* [1893] 1 Ch 484, 491 per Fry LJ.

59 *Re Guardian Assurance Co* [1917] 1 Ch 413; *Re International Harvester Co of Aust Pty Ltd* [1953] VLR 669, 672 per Lowe ACJ.

60 *Re Guardian Assurance Co* [1917] 1 Ch 413; *Re Opes Prime Stockbroking Ltd* [2009] FCA 813; (2009) 179 FCR 20 (appeal dismissed: *Fowler v Lindholm* [2009] FCAFC 125; (2009) 178 FCR 563).

61 *Re NFU Development Trust Ltd* [1973] 1 All ER 135; *Re Opes Prime Stockbroking Ltd* [2009] FCA 813; (2009) 179 FCR 20 (approved in *Fowler v Lindholm* [2009] FCAFC 125, [67]; (2009) 178 FCR 563).

62 *ASC v Marlborough Gold Mines Ltd* [1993] HCA 15; (1993) 177 CLR 485, 501; *Re International Harvester Co of Australia Pty Ltd* [1953] VLR 669.

63 *Re International Harvester Co of Aust Pty Ltd* [1953] VLR 669, 672 per Lowe ACJ. See also *Fowler v Lindholm* [2009] FCAFC 125; (2009) 178 FCR 563.

64 *ASC v Marlborough Gold Mines Ltd* [1993] HCA 15; (1993) 177 CLR 485; *Re Glendale Land Development (in liq)* [1982] 2 NSWLR 563.

65 *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213, 237 per Lindley LJ; *Isles v The Daily Newspaper* [1912] HCA 18; (1912) 14 CLR 193.

66 *Re Midland Coal, Coke and Iron Co* [1895] 1 Ch 267; *Re Glendale Land Development Ltd (in liq)* [1982] 2 NSWLR 563; *Bond Corp Holdings Ltd v WA* (1992) 7 WAR 61. The holder of options over shares in the company has been held to be a creditor for this purpose: *Re Westgold Resources Ltd* [2012] WASC 301.

67 See Pilkington, above n 31, Ch 7; Jennifer Payne, above n 5, [5.2.4].

68 *Re Dunderland Iron Ore Co Ltd* [1909] 1 Ch 446 (arguably no longer good law in Australia: *Federal Commissioner of Taxation v Unilever Australia Securities Ltd* (1995) 56 FCR 152; *Re Kershaw* [2005] NSWSC 313; (2005) 54 ACSR 214).

69 *Re Boart Longyear Ltd* [2017] NSWSC 567, [29] (the notes were in a global form, which was not fully explained in the case but see Andrew McKnight, *The Law of International Finance* (2008), Ch 10, which discusses global note issues). See also *Re Castle Holdco 4 Ltd* [2009]

A person who is not a creditor may be included in the scheme provided that the scheme is still made between the company and its creditors, and there is a nexus between the third party (or rights of creditors against the third party) and the relationship of debtor and creditor between the company and its creditors.[70] This offers a significant advantage over a voluntary administration followed by a deed of company arrangement, which cannot include creditor rights against third parties.[71]

Implementation of a creditors' scheme requires the following steps to be taken:

1. Formulating the scheme and preparing the explanatory statement[72] that will be provided to creditors;[73]
2. Applying to the court for permission to convene meetings of creditors who will be covered by the scheme, to vote on a scheme proposal. It is possible for a stay to be granted by the court pending the approval of the scheme.[74]
3. The Australian Securities and Investment Commission (ASIC) (the corporate regulator) must be given prior notice of the application so that it can comment on the proposal and draft explanatory statements;[75]
4. Notice must also be given to creditors of the court application so that they may seek leave to appear before the court;[76]
5. If court approval is given, distribute the explanatory statement to creditors and convene a meeting(s) of the class(es) of creditors who will be covered by the scheme to vote on the scheme proposal
6. Creditors must approve of the scheme proposal by a majority in number which must represent 75% of the value. These calculations are done on creditors who are voting at the meeting either in person or by proxy.[77] It is not a requirement to obtain the approval of a majority of all creditors of the company or all of the creditors in the class.

EWHC 3919 (Ch) (the bonds did state that an event of default would result in a transfer of the bonds to the ultimate beneficial owners if they request it); *Re Magyar Telecom BV* [2013] EWHC 3800 (Ch) (bond indenture stated that bonds could be registered in names of account holders); *Re Co-Operative Bank Plc* [2013] EWHC 4072 (Ch) (the notes were held by a trustee but the ultimate beneficiaries had the right to call for the notes to be transferred into their name).

70 *Fowler v Lindholm* [2009] FCAFC 125, [73]; (2009) 178 FCR 563.

71 *Lehman Brothers Holdings Inc v City of Swan* [2010] HCA 11; (2010) 240 CLR 509; Jason Harris, 'Adjusting creditor rights against third parties during debt restructuring' (2011) 19 *Insolvency Law Journal* 22.

72 *Corporations Act 2001* (Cth) s 412.

73 See generally Damian and Rich, above n 52, Ch 5.

74 *Corporations Act 2001* (Cth) s 411(16). *Re GAE Pty Ltd* [1962] VR 252; *Re Boart Longyear Ltd* [2017] NSWSC 537. An injunction pending a scheme has also been issued under general court rules in England (*Bluecrest Mercantile BV v Vietnam Shipbuilding Industry Group* [2013] EWHC 1146 (Comm)) and in at least one case in Australia (*Bond Corp Holdings Ltd v WA* (1992) 7 WAR 61). It is also possible to obtain a moratorium by putting the company into a provisional liquidation pending the approval of the scheme.

75 *Corporations Act 2001* (Cth) s 411(2). ASIC's approach is explained in Damian and Rich, above n 52, 517-518.

76 See the discussion in *Re Opes Prime Stockbroking Ltd* [2009] FCA 813; (2009) 179 FCR 20 (applying *Re Hawk Insurance Co Ltd* [2001] 2 BCLC 480).

77 *Corporations Act 2001* (Cth) s 411(4).

7. If the creditors approve of the proposal, seek court approval to implement the scheme.[78]

If the court approves the scheme then the scheme will bind all creditors in the class to whom the scheme applies.[79] This will include creditors who did not vote but who are in the same class as those who voted. There is no need for a scheme to cover all creditors or all classes of creditors, although it is possible for a scheme to cover all creditors.[80]

The court can consider class composition issues at the first meeting, although given many creditors may not be present at the first meeting any problems arising from class composition can be finally determined at the second meeting.[81]

It is not the role of the court to consider the detail of the scheme proposal to assess it for overall fairness at the stage of the first court hearing,[82] although a court will not allow a creditors' meeting to be convened to consider the scheme proposal if the scheme is so unfair (or illegal) that it is bound to be rejected at the second hearing.[83] The NSW Court of Appeal has recently explained that: 'the task of the Court at the first hearing is to determine whether the scheme is of such a nature and in such terms that if it obtained the statutory majority the Court would be likely to approve it on an unopposed subsequent hearing'.[84]

The court's role at the second hearing is to consider:[85]

a) Whether the terms of the statute have been complied with in conducting the creditor meeting(s)
b) Whether the classes were fairly represented by those who attended the meeting and that the majority were acting bona fide and not oppressing the minority
c) Whether the arrangement is such that an intelligent and honest person, if a member of the class concerned and acting within their interests, might reasonably approve

The test is not simply whether one or more creditors have reasonable objections to the scheme.[86] While the court will have regard to the wishes of the majority of creditors,[87] particularly where they are experienced business people with independent advisors, the court must still be satisfied of the fairness of the scheme proposal.[88] As the Full Federal Court has explained, 'schemes [must] meet the test of fairness to the body of creditors as a whole; the test is not fairness to a particular creditor in the peculiar

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78 Ibid.
79 Ibid.
80 *Corporations Act 2001* (Cth) s 411(1).
81 *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116, [40]-[41]; *Re Opes Prime Stockbroking Ltd (No 2)* [2009] FCA 813, [17]-[20]; (2009) 179 FCR 20.
82 *Re Telewest Communications Plc* [2004] EWHC 924 (Ch), [14] per Richards J.
83 *Re CSR Ltd* [2010] FCAFC 34, [61]; (2010) 183 FCR 358 per Keane CJ and Jacobson J.
84 *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116, [39].
85 *Re Opes Prime Stockbroking Ltd (No 2)* [2009] FCA 864; [8]; (2009) 73 ACSR 411 per Finkelstein J.
86 *Re British Aviation Insurance Co Ltd* [2005] EWHC 1621.
87 *Re English Scottish and Australian Chartered Bank* [1893] 3 Ch 385, 409 per Lindley LJ (the creditors are 'much better judges of what is to their commercial advantage than the court can be').
88 *Re Opes Prime Stockbroking Ltd (No 2)* [2009] FCA 864, [27]; (2009) 73 ACSR 411 per Finkelstein J; *Bacnet Pty Ltd v Lift Capital Partners Pty Ltd (in liq)* [2010] FCAFC 36, [150]; (2010) 183 FCR 384.

circumstances of its case'.[89] If there are concerns about how creditor claims have been assessed (including as to valuation issues) this is something that is appropriately dealt with at the second court hearing.[90] If a person wishes to impugn the creditor vote on the basis of some collateral interest held by particular creditors in a class and not others, it must be shown:

> that an intelligent and honest member of the class without those collateral interests could not have voted in the way that he did. It is not sufficient simply to show that the collateral interest is an additional reason for voting in the manner in which he would otherwise have voted.[91]

It is clear however that: '[t]he Court's role is not to substitute its own assessment of what is reasonable for that of the creditors. They are much better judges of what is in the commercial interests of the class they represent than the court'.[92]

The court can consider the potential effect of the scheme on third parties who are not themselves parties to the scheme if they have a legitimate interest in the deployment of the company's assets,[93] which means creditors who are not included within the scheme may still have their position considered by the court in deciding whether to approve of the scheme. It must be remembered that parties whose legal rights are affected by the scheme must be included within its terms and must therefore be given a vote, which may therefore give rise to differential voting in respect of the scheme between classes of creditors and potentially between creditors and members.[94]

IV CLASS COMPOSITION ISSUES

A *Overview*

Schemes can cover some or all creditors, as well as some or all members, including holders of convertible and hybrid securities. A scheme can also include a specific class of creditors (such as senior secured lenders in a loan syndication), or noteholders of one or more series of notes.[95] Whatever the target group, the scheme proponents will need to consider whether the nature of the legal rights held by the group members are sufficiently similar (or not so dissimilar that they cannot vote together) so as to constitute a single class. If their rights are too different then multiple classes will need to be convened, and each class will need to approve the scheme proposal.[96]

A class that does not have their rights affected by a scheme need not be

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89 *Bacnet Pty Ltd v Lift Capital Partners Pty Ltd (in liq)* [2010] FCAFC 36, [151]; (2010) 183 FCR 384.

90 *Re Sinclair Knight Merz Pty Ltd* [2012] FCA 1391, [28].

91 *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch), [130] per Hildyard J.

92 *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch), [128] per Hildyard J.

93 *Re Centro Properties Ltd* [2011] NSWSC 1465, [26]-[27]; (2011) 86 ACSR 584 per Barrett J.

94 Members' interests would be disregarded if the company were insolvent: *Re Tea Corp Ltd* [1904] 1 Ch 12. Also, members with claims as creditors may be subject to subordination under s 563A (depending on the nature of their claim. Subordinated claim holders are not permitted to vote: s 411(5A). See also *Re Atlas Iron Ltd* [2016] FCA 366; (2016) 112 ACSR 554.

95 See further LexisNexis, above n 29, Ch 3 and Ch 5.

96 For a critical review of English and New Zealand law see Michael Josling, 'An Analysis of the Rights Test in Determining Classes of Creditors' (2010) 18 *Insolvency Law Journal* 110. For further discussion of the Australian law see: Damian and Rich, above n 52, Ch 6.

included.[97] This includes situations where one or more classes of creditors may be underwater on a proper valuation of the assets. Business valuation is a complex topic that is beyond the scope of this article.[98] However, in brief, a valuation may adopt a number of methodologies depending on the nature of the business and the availability of comparable transactions and businesses.[99] Restructuring of listed entities provides for a wealth of financial and market information, while unlisted companies in markets without comparable transactions may be more difficult to value. For financially distressed companies that are likely to default on major debt obligations if the scheme fails, it may be appropriate to adopt a liquidation value as the appropriate measure of the company's value.[100] Clearly, the higher the company's estimated value, the more likely that the capital structure breaks further down the priority ranking. Mezzanine debtors (such as note holders) may therefore push for a different valuation method that will yield a higher valuation in order to show that their debt still retains value and must therefore be included in the scheme if the scheme will affect their rights.[101]

Creditors' schemes will often need to be separated into different voting classes, which is explained in the next section. It is important to note however that where multiple classes are established, the requisite majority votes will need to be obtained from *each* of the classes. Dissenting creditors have an incentive to push for their claims to be placed into a separate class so that they have a better chance of rejecting the scheme compared with the situation where they form part of a larger class dominated by those who support the scheme.

A cross-class cram down mechanism would address this greenmail by giving scheme proponents the potential to obtain court sanction for the scheme despite a minority of creditors voting against it. While it is arguable that greenmailing provides a counter-balance to the voting power of the majority lenders, that counter-balance is also provided through the role of the two court hearings and the power of the court to refuse to approve the scheme where it is unfair to the creditors as a whole. Furthermore, the need for careful class composition can delay a scheme proposal before making the initial court application which may put the company at risk of individual creditor enforcement action.

B *The class composition test*

One of the major issues that arise in creditors' schemes of arrangement is the determination of what classes of creditors will be used to conduct the vote on a scheme proposal, which may be considered at the first court meeting to ensure that the scheme process is not wasted if classes are improperly drawn.[102] The court will consider the

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[97] *Re Tea Corp Ltd* [1904] 1 Ch 12; *Re Bluebrook Ltd* [2010] EWHC 2114 (Ch). See also *Re Opes Prime Stockbroking Ltd* [2009] FCA 813; (2009) 179 FCR 20; *Re Centro Properties Ltd* [2011] NSWSC 1171; (2011) 87 ACSR 131.

[98] See further Robert Stark, Howard Siegel, and Edward Weisfelner, *Contested Valuation in Corporate Bankruptcy* (2011).

[99] For an overview of different valuation methodologies in corporate restructuring see Howard and Hedger, *Restructuring Law and Practice* (2nd ed, 2014) Ch 5; Christopher Sontchi, 'Valuations Methodologies: A Judge's View' (2012) 20 *American Bankruptcy Institute Law Review* 1.

[100] For a recent application of this see *Re Nexus Energy Ltd (subject to DOCA)* [2014] NSWSC 1910; (2014) 105 ACSR 246.

[101] This occurred in *Re Bluebrook Ltd* [2010] EWHC 2114 (Ch).

[102] *Re Hawk Insurance Co Ltd* [2001] 2 BCLC 480 (applied in Australia by *Re Opes Prime Stockbroking Ltd* [2009] FCA 813; (2009) 179 FCR 20).

overall fairness of the scheme at the final meeting however, and class composition can be addressed as part of this analysis by the court.[103]

The classic explanation of how a class is to be determined in a creditors' scheme was given by Bowen LJ in *Sovereign Life Assurance Co v Dodd*:

> It seems plain that we must give such a meaning to the term 'class' as will prevent the section being so worked as to result in confiscation and injustice, and that it must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.[104]

The question of class composition is difficult because drawing the class too broadly could result in empowering the majority to oppress a minority that has different legal rights,[105] while drawing the class definition too narrowly (and thereby allowing for a variety of classes) could enable a small minority to frustrate the wishes of the majority. As Lord Millett said in *UDL Argos Engineering & Heavy Industries Co Ltd v Li Oi Lin*: 'Fragmenting creditors into different classes gives each class the power to veto the Scheme and would deprive a beneficent procedure of much of its value.' [106]

In the Australian decision involving the collapse of a large securities firm Opes Prime, Justice Finkelstein explained:

> practical considerations are relevant. If a judge is too assiduous in identifying classes, it is possible to end up with any number of classes. In the end, schemes of arrangement are propounded in a business context. The judge should adopt a practical business-like approach to the issue, as would the creditors if they were to decide the matter. [107]

In *UDL* Lord Millett summarised the law as follows (at [27]):

> The following principles can be derived from this consistent line of authority:
>
> (1) It is the responsibility of the company putting forward the Scheme to decide whether to summon a single meeting or more than one meeting. If the meeting or meetings are improperly constituted, objection should be taken on the application for sanction and the company bears the risk that the application will be dismissed.
>
> (2) Persons whose rights are so dissimilar that they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to their common interest should be summoned to a single meeting.
>
> (3) The test is based on similarity or dissimilarity of legal rights against the company, not on similarity or dissimilarity of interests not

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[103] *Re Opes Prime Stockbroking Ltd* [2009] FCA 813, [85]; (2009) 179 FCR 20; *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116, [40].

[104] [1892] 2 QB 573, 583.

[105] In *Re Opes Prime Stockbroking Ltd* [2009] FCA 813, [66]; (2009) 179 FCR 20, Finkelstein J noted that the second court hearing is a built-in protection against oppression.

[106] [2001] 3 HKLRD 634, [26]. See also *Re Opes Prime Stockbroking Ltd* [2009] FCA 813, [66]; (2009) 179 FCR 20 per Finkelstein J.

[107] *Re Opes Prime Stockbroking Ltd* [2009] FCA 813, [66]; (2009) 179 FCR 20.

derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.

(4) The question is whether the rights which are to be released or varied under the Scheme or the new rights which the Scheme gives in their place are so different that the Scheme must be treated as a compromise or arrangement with more than one class.

(5) The Court has no jurisdiction to sanction a Scheme which does not have the approval of the requisite majority of creditors voting at meetings properly constituted in accordance with these principles. Even if it has jurisdiction to sanction a Scheme, however, the Court is not bound to do so.

(6) The Court will decline to sanction a Scheme unless it is satisfied, not only that the meetings were properly constituted and that the proposals were approved by the requisite majorities, but that the result of each meeting fairly reflected the views of the creditors concerned. To this end it may discount or disregard altogether the votes of those who, though entitled to vote at a meeting as a member of the class concerned, have such personal or special interests in supporting the proposals that their views cannot be regarded as fairly representative of the class in question.

In *Re Opes Prime Stockbroking Ltd* Finkelstein J held that:

> [66] The application of the relevant test involves a comparison of the rights creditors have in the absence of the scheme and any new rights that are established under the scheme[…]
> [71] […] the existence of separate commercial or other interests is not relevant to the class issue. This is not to suggest that different interests are irrelevant. The existence of different interests may be a factor that can be taken into account if the court comes to decide whether it should approve the schemes. [108]

A distinction is therefore drawn between the *rights* of creditors within the purported class and their *interests*.[109] In *Opes Prime*, Finkelstein J held:

> the existence of separate commercial or other interests is not relevant to the class issue. This is not to suggest that different interests are irrelevant. The existence of different interests may be a factor that can be taken into account if the court comes to decide whether it should approve the schemes. [110]

The approach taken by Justice Finkelstein in *Opes* was applied on appeal, and has been subsequently applied in other decisions.[111]

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[108] [2009] FCA 813 applying *Re T&N Ltd* [2006] EWHC 1447 (Ch).
[109] See also *Re Telewest Communications Plc* [2004] EWHC 924 (Ch).
[110] [2009] FCA 813, [71].
[111] *Fowler v Lindholm* [2009] FCAFC 125; (2009) 178 FCR 563 (appeal from *Opes* dismissed); *Re Nine Entertainment Group Ltd (No 1)* [2012] FCA 1464; (2012) 211 FCR 439; *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

Examples of matters that have been held to be interests that do not affect rights, and hence did not require separate classes, include:

- Creditors who will receive different interest rates or whose debts are repayable at different times;[112]
- Creditors who were to be repaid in different currencies but under the scheme will be paid in a single currency;[113]
- Participation of certain creditors in lock up arrangements that contractually oblige them to vote in favour of the scheme (with a fiduciary carve out);[114]
- Creditors who receive nominal incentive fees to participate in a lock up agreement;[115]
- Participation of certain creditors in providing a new loan facility to the company;[116]
- Rights given to certain creditors to appoint directors to the restructured company;[117]
- The requirement that a group of lenders be required to waive a change of control default clause (in the context of the company otherwise being insolvent and the scheme proponent wanting majority control through a debt for equity swap in order to support the scheme);[118]
- The fact that the scheme proponents were also shareholders and directors as well as being unsecured creditors did not require them to be placed in a separate class;[119]
- The fact that only some creditors will receive new equity (in the context of only those creditors holding equity prior to the scheme);[120]
- Intra-group creditors;[121]
- Debenture holders who were also shareholders.[122]

[112] *Re McCarthy & Stone Plc* [2009] EWHC 712 (Ch); *Primacom Holdings GmbH v Credit Agricole* [2011] EWHC 3746 (Ch); *Re NEF Telecom Co BV* [2012] EWHC 2483; *Cortefiel, SA v Mep 11.S.A.R.L.* [2012] EWHC 2998 (Ch); *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

[113] *Re Telewest Communications Plc* [2004] EWHC 924; *Re DX Holdings Ltd* [2010] EWHC 1513.

[114] *Primacom Holding GmbH v Credit Agricole* [2011] EWHC 3746 (Ch), [54]; *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

[115] *Re Telewest Communications Plc* [2004] EWHC 924; *Re DX Holdings Ltd* [2010] EWHC 1513; *Primacom Holding GmbH v Credit Agricole* [2011] EWHC 3746 (Ch); *Re Seat Pagine Gaialle SpA* [2012] EWHC 3686 (Ch); *Cortefiel, SA v Mep 11.S.A.R.L.* [2012] EWHC 2998 (Ch), [22].

[116] *Primacom Holding GmbH v Credit Agricole* [2011] EWHC 3746 (Ch); *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

[117] *Re Nine Entertainment Group Ltd (No 1)* [2012] FCA 1464; (2012) 211 FCR 439; *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

[118] *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

[119] *Re Jax Marine Pty Ltd* (1966) 85 WN (NSW) 130; *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

[120] *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

[121] *Re Landmark Finance Corp Ltd* [1968] 1 NSWR 145 (applied in *Re Telewest Communications Plc* [2004] EWHC 924).

[122] *Re Chevron (Sydney) Ltd* [1963] VR 249; *First Pacific Advisors LLC v Boart Longyear Ltd* [2017] NSWCA 116.

Scheme creditors who have different priority under the statute should be placed into a separate class to other creditors,[123] particularly if their priority will be affected. If there are concerns about the ability of priority creditors to veto a scheme it is possible that the scheme will involve paying priority creditors (such as employees) in full and therefore their rights would not be affected and they need not be included in the scheme. For companies that would be clearly insolvent in the absence of the scheme it is possible that the priority creditors would receive no return in a liquidation (applying the *Tea Corp* principle)[124] they need not be included in the scheme.[125] However, given the priority that employee creditors have over circulating security interests[126] it is advisable that employees are paid their statutory entitlements rather than be included in the scheme.

D *Critique*

While it is clear that creditors or members whose legal rights are affected by a scheme must be included, the delineation between legal rights and commercial interests is not a bright line standard that can be easily applied in formulating creditors' schemes. As all classes will need to approve of the scheme, this can lead to undue delays and further complexity where the majority of creditors in number and value can be subject to greenmailing by minority creditors. Furthermore, delays in seeking court permission to convene the creditors' meeting while class composition issues are addressed leaves the debtor company vulnerable to enforcement action from creditors as there will be no stay against claims in place. Minority interests can be adequately protected by the need to secure court approval to implement a scheme even where the overwhelming majority of creditors vote in favour of it, in order to protect against oppression or fraud on a power.

The threat of greenmail by minority creditors to hold up a restructuring using a scheme can lead to significant value leakage from the restructuring where the scheme proponents need to effectively pay off minority class creditors in order to secure their approval. A cross-class cram down mechanism could allow for court approval of the scheme even where one or more junior classes dissents, provided that they are treated fairly (for example by ensuring that they receive at least what they would in a liquidation of the company).

Furthermore, the current law provides little protection of debt over equity, particularly where the company is not insolvent but is financially distressed and would benefit from a financial restructuring. While members who claim as creditors based on the circumstances concerning their shareholding (such as the decision to buy shares or the decision to sell or hold their shares) are subordinated under s 563A and s 411(5A) of the *Corporations Act*, members who do not claim creditor status are not subordinated. Thus, equity holders may argue that a scheme affects their legal rights and therefore they must be included within the scheme and given a vote.[127] A common example where this will occur is in restructuring companies with stapled securities,

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[123] *Re Brian Cassidy Electrical Industries Pty Ltd* (1984) 9 ACLR 140; *Re Richards & Co* (1879) 11 Ch D 676.

[124] *Re Tea Corp Ltd* [1904] 1 Ch 12.

[125] Contrast Garry Hamilton, 'Creditors and Classes of Creditors in the Context of Corporate Statutory Schemes of Arrangement' (1994) 2 *Insolvency Law Journal* 176.

[126] *Corporations Act 2001* (Cth) ss 433, 561.

[127] For an argument that equity should be given a role in restructuring see: Stephan Madaus, 'Reconsidering the Shareholder's Role in Corporate Reorganisations under Insolvency Law' (2013) 22 *International Insolvency Review* 106.

such as real estate investment trusts.[128] At present there is no version of the 'absolute priority rule' in relation to restructuring using a creditors' scheme.[129]

A cross-class cram down mechanism would offer a range of benefits to make creditors' schemes a more efficient and attractive restructuring tool. First, it would discourage greenmailing by junior creditors as they could be bound by a scheme even if they voted against it provided the court approved it. Secondly, a cross-class cram down power would also reduce concerns about class composition. Currently, considerable effort is put into composing classes, often where dissenting creditors are sought by the scheme proponents to be included within a class of majority creditors supporting the scheme lest the multiplication of classes dooms the scheme. Alternatively, scheme proponents may seek to avoid including the dissenting creditors by relying on *Tea Corp*[130] and arguing that the enterprise value has that class of creditors underwater which leads to complex financial arguments regarding the valuation of the entity for the purposes of determining where the break in the capital structure falls. Thirdly, a cross-class cram down mechanism would assist with creditor concerns about value leakage to equity.

The next section will show that while cross-class cram down is a well-known feature of the US Chapter 11 reorganisation procedure, it is a concept that is growing in popularity in both common law and non-common law jurisdictions through reforms introduced since the Global Financial Crisis.

V Cross-Class Cram Down Mechanisms

A *Operation of cram down in the United States*

The concept of cram down in the United States refers to the power of the court to confirm a reorganization plan under Chapter 11 of the Bankruptcy Code where the plan has not been accepted by the requisite majority for each relevant class.[131] The Bankruptcy Code requires plans under Chapter 11 to be accepted by each class of impaired claimants.[132] An impaired class is, broadly speaking, one whose creditors or interest holders will have their rights varied by the plan.[133] A failure to provide full payment is a variation of rights for this purpose. A class that is not impaired does not need to vote as they are conclusively presumed to have accepted the plan.[134] Similarly, a class that is to receive nothing under the plan is deemed to have rejected the plan.[135] An impaired class of creditors can accept the plan by a majority vote in number and 2/3[rds] in value for that that class.[136]

The court is required to confirm a plan under Chapter 11 where certain conditions are met, such as compliance with the Bankruptcy Code, the plan proponent acting in good faith, and the requisite voting requirements have been met for all impaired

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128 See *Re Centro Properties Ltd* [2011] NSWSC 1171; (2011) 87 ACSR 131.
129 The absolute priority rule is a US bankruptcy concept that is discussed further below.
130 *Re Tea Corp Ltd* [1904] 1 Ch 12.
131 11 USC §1129(b).
132 11 USC §1129(a)(8).
133 11 USC §1124.
134 11 USC §§1126(f), 1129(a)(8)(B).
135 11 USC §1126(g).
136 11 USC §1126(c). The court has the power to exclude particular creditors from the calculation under §1126(e).

classes.[137] The plan must also not be likely to be followed by liquidation, unless that is expressly stated in the plan.[138] The Code also requires a comparison with returns in liquidation (which occurs under Chapter 7 of the Bankruptcy Code) so that all impaired classes must receive not less than the amount that they would receive in liquidation. An impaired class that accepts the plan is not subject to the same requirement.[139]

In order for cram down to operate, there must be at least one impaired class that has accepted the plan, without including acceptances from insiders.[140] The court may confirm the plan where all of the requirements of §1129(a) have been satisfied except the requirement for acceptance by all impaired classes, and the plan does not discriminate unfairly,[141] and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.[142] The court is required to determine whether the requirements have been met and cannot rely merely on a lack of formal objections from class members.[143]

Establishing that a plan is fair and equitable with respect to a class requires that:

- Secured creditors' security over collateral is protected,[144] or that the security attaches to proceeds of a sale of the collateral[145] or they receive 'the indubitable equivalent' of their claims;[146]
- Unsecured creditors either receive of their admitted claims, or that any junior classes of creditors or interests not receive any property, which is known as the absolute priority rule.[147]
- The majority of applications for cram down involve secured creditor class dissent.[148]

The next section shows that cross-class cram down mechanisms are becoming increasingly popular in modern restructuring laws.

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[137] 11 USC §1129(a).
[138] 11 USC §1129(a)(11).
[139] 11 USC §1129(a)(7).
[140] 11 USC §1129(a)(10).
[141] See *In re Dura Automotive Systems Inc* (2007) 379 BR 257 (Bankr D Del). The standard for assessing unfair discrimination is whether dissenting classes will receive value equal to the value given to all other similarly situated classes, that is those who hold similar legal claims: *In re Trenton Ridge Investors LLC* (2011) 461 BR 440 (Bankr SD Ohio). The comparison is between classes that reject the plan, an impaired class that rejects the plan but receives better treatment than an impaired class that accepts the plan is not unfairly discriminated against: *In re Sentinel Management Group Inc* (2008) 398 BR 281 (Bankr ND Ill).
[142] 11 USC §1129(b)(1).
[143] See *In re Lett* (2011) 632 F.3d 1216 (USCA 11th Cir).
[144] 11 USC §1129(b)(2)(A)(i). See further Jack Friedman, 'What Courts Do to Secured Creditors in Chapter 11 Cram Down' (1993) 14 *Cardozo Law Review* 1495; Westlaw, *Chapter 11 Reorganization* (2nd ed, February 2017) §14.17-§14.20.
[145] 11 USC §1129(b)(2)(A)(ii).
[146] 11 USC §1129(b)(2)(A)(iii). See further Westlaw, *Chapter 11 Reorganization* (2nd ed, February 2017) §14.23.
[147] See further Stephen Lubben, 'The Overstated Absolute Priority Rule' (2016) 21 *Fordham Journal of Corporate and Finance Law* 581.
[148] *River Road Hotel Partners LLC v Amalgamated Bank* (2011) 651 F.3d 642, 647-8 (USCA 7th Cir).

B *Law reform in other common law jurisdictions*

Common law countries usually have a creditors' scheme of arrangement procedure which is based on the English scheme provisions. As the English scheme provisions do not provide for cross-class cram down,[149] neither do the provisions in other common law countries, such as Hong Kong,[150] Bermuda,[151] Ireland,[152] Malaysia,[153] or Nigeria.[154] Other common law countries that have formal debt restructuring mechanisms such as Canada,[155] South Africa[156] and New Zealand[157] also do not provide for cross-class cram down. However, with many jurisdictions actively seeking more restructuring work from both domestic and international companies, and the increasingly international flow of funds for restructuring efforts, this traditional refusal to allow for cross-class cram down may be changing.

Singapore has recently enacted major insolvency and restructuring reforms in order to establish itself as a global and regional restructuring hub. On 10 March 2017, the Singaporean parliament passed the Companies (Amendment) Bill 2017. These reforms will alter the creditors' scheme provisions in Singapore in order to make them more attractive as a debt restructuring tool, including introducing a moratorium for schemes, allowing for pre-pack schemes to be approved without creditor meetings, protection for interim financing and providing for cross-class cram down.[158]

The Singaporean cram down mechanism is modelled closely on the US Chapter 11 model in §1129.[159] The new provision requires that at least one class of creditors has approved of the scheme proposal by a majority in number and ¾ in value for creditors voting in person or by proxy in that class.[160] Where at least one class does not approve the scheme proposal then the court may still sanction the scheme and make the scheme binding on the classes covered by it, where the requirements of the new s 211H are satisfied. Those requirements are:[161]

- The majority in number and ¾ in value requirements are satisfied for the creditors as a whole, for those who voted in person or by proxy;
- The court is satisfied that the scheme does not discriminate unfairly between 2 or more classes of creditors; and
- The court is satisfied that the scheme is fair and equitable to each dissenting class.

A scheme that pays less than a liquidation will not be fair and equitable to a dissenting class.[162] Section 211H also adopts the measure of protection for secured

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[149] *Companies Act 2006* (UK) Part 26.
[150] *Companies Ordinance 2012* (HK) (Cap 622) Part 13.
[151] *Companies Act 1981* (Bermuda) s 99.
[152] *Companies Act 2014* (Ireland) s 453.
[153] *Companies Act 2016* (Malaysia) s 366.
[154] *Companies and Allied Matters Act 1990* (Nigeria) s 539.
[155] *Companies Creditors' Arrangement Act 1986* (RSC).
[156] *Companies Act 2008* (SA) Ch 6 (Business Rescue and Compromises with Creditors).
[157] *Companies Act 1993* (NZ) Pts 14 (Compromises with Creditors) and 15 (Approval of Arrangements, Amalgamations and Compromises by Court).
[158] See the detailed review by Herbert Smith Freehills, *Guide to Restructuring, Turnaround and Insolvency in Asia Pacific 2016* (2016), <www.hsf.com.au>.
[159] See new s 211H in the *Companies Act 1967* (SG) (Chapter 50).
[160] See *Companies Act 1967* (SG) s 210(3AB).
[161] *Companies Act 1967* (SG) s 211H(3).
[162] *Companies Act 1967* (SG) s 211H(4)(a).

creditors that is contained in §1129(b)(2)(A) of the US Chapter 11 procedure.[163] The reforms also allow for an expert to be appointed to assist the court with valuations.[164] An application for cram down may be made by the company or a creditor (with leave of the court).[165]

In England, the Insolvency Service has also proposed a cross-class cram down mechanism. In May 2016, the Insolvency Service released a discussion paper 'A Review of the Corporate Insolvency Framework',[166] which included a proposal for a 'flexible restructuring plan' that would introduce a cross-class cram down on junior creditors. The junior creditor classes subject to cram down would need to be paid at least what they would recover in liquidation. The Discussion Paper noted that such a mechanism could offer efficiency benefits over the current procedure to deal with junior creditors through the use of transfer schemes, leaving the junior creditors in the former entity.[167] The Discussion Paper also notes that cram down would address concerns about greenmailing by junior creditor classes.[168]

This proposal would introduce a new multi-class restructuring procedure to aid corporate rescue that would work in addition to schemes of arrangement. Debtors would propose class compositions to the court when seeking to invoke the procedure, and the court could reject the proposed classes by applying the *Sovereign Life* test.[169] The court would also need to approve the plan and could only do so where it would leave creditors no worse off than liquidation. In September 2016, the Insolvency Service released the Government's feedback on submissions made regarding the Discussion Paper. Of submissions that addressed cram-down, sixty one percent supported it.[170] Submissions also recommended that the proposal be expanded to include shareholders.[171] At the time of writing no further announcement had been made regarding the implementation of these proposed reforms, with the English civil service occupied with managing Britain's exit from the European Union.

C *Cram down in non-common law countries*

This section provides a brief overview of cram down mechanisms applying non-common law restructuring mechanisms. An extended examination of these jurisdictions is outside of the scope of this article.

China introduced a cross-class cram down mechanism in Articles 86 and 87 of its Enterprise Bankruptcy Law in 2006.[172] Japan also allows for cram down in its

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[163] This provides that secured creditors are entitled to retain their liens and receive deferred cash payments for the value of the claim at the date of plan or that they receive consideration that is the 'indubitable equivalent' of such claims. See Westlaw, *Chapter 11 Reorganization* (2nd ed, February 2017) §14.17-§14.20. One significant difference is that the absolute priority rule, which is not a Singaporean principle, is narrowed so that only junior creditors must not receive any payment before senior creditors. Equity holders are not mentioned in s 211H(4)(b)(ii)(B).

[164] *Companies Act 1967* (SG) s 211H(5).

[165] *Companies Act 1967* (SG) s 211H(2).

[166] <https://www.gov.uk/government/consultations/a-review-of-the-corporate-insolvency-framework>.

[167] Discussion Paper at [9.9].

[168] Discussion Paper at [9.13].

[169] See above n 104.

[170] Response Paper at [4.5].

[171] Response Paper at [4.6].

[172] See Zuofa Wang, 'The Political Economy of the Implementation of the Bankruptcy Law of China' (2015) 6 *Asian Journal of Law and Economics* 249; Emily Lee, 'China's New Enterprise Bankruptcy Law: A Great Leap Forward, But Just How Far? (2010) 19 *International Insolvency Review* 145.

corporate reorganization proceedings through a court order confirming the reorganization plan.[173] There has also been discussion of the possibility of extending cross-class cram into the 'alternate dispute resolution' for business turnaround (or revitalization) procedure.

Looking to Europe, Italy in 2009 introduced a new 'pre-bankruptcy agreement' procedure, which is court supervised and allows for a majority of creditors classes (which can include both secured and unsecured) to bind the minority classes with court approval. The numbers of European countries with cross-class cram down mechanisms in their restructuring laws is likely to increase in the near future.[174] The European Commission released a proposed directive on 22 November 2016,[175] which recommends that member states introduce a cross-class cram down mechanism, provided that at least one class of creditors approves of the reorganization plan, and the absolute priority rule is complied with.[176] The plan must also be approved by a majority of creditors, whose debts must make up at least 75% of the value of debts owed by the debtor.[177] As the European Commission's recommendation has only been released recently it has not been specifically actioned by any EU member state at the time of writing. It is likely though that it will be implemented by member states in the future and this will put further pressure on England to introduce a cross-class cram down at some point in the future if it wishes to retain its prominent place as an international restructuring hub.

There has been extensive debate concerning a proposal to introduce a Dutch scheme of arrangement procedure, which is likely to include a cross-class cram down, based on the draft bill.[178] The current draft bill was released in 2014, which pre-dates the EC recommendation and at the time of writing had not been updated in response to the recommendation.

VI Does Australia Need a Cross-Class Cram Down Mechanism?

Cross-class cram down is a restructuring tool whose time has come, and should be introduced into Australian law. While creditors' schemes of arrangement rely upon a procedure that is derived from traditional English insolvency law dating back to the 1860s, the times have changed, as have businesses and forms of financing both for

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[173] *Corporate Reorganization Act 2002* (Japan) Art 200(1). See further, Samuel Bufford and Kazuhiro Yanagida, 'Japan's Revised Laws on Business Reorganization: An Analysis' (2006) 39 *Cornell International Law Journal* 1; Stacie Steel, 'Insolvency Law in Japan' in Roman Tomasic (ed), *Insolvency Law in East Asia* (2006) Ch 2; Shinjiro Takagi, 'Restructuring in Japan' (2003) 12 *International Insolvency Review* 1.

[174] Germany permits cram down for restructuring certain financial institutions: see Kreditinstute-Reorganisationsgezetz, as explained in Tomas Arons, 'Recognition of Debt Restructuring and Resolution Measures under the European Union Regulatory Framework' (2014) 23 *International Insolvency Review* 57.

[175] European Commission, 'Proposal for a Directive of the European Parliament and of the Council on Preventive Restructuring Frameworks, Second Chance and Measures to Increase the Efficiency of Restructuring, Insolvency and Discharge Procedures and Amending Directive 2012/30/EU, COM/2016/0723 final - 2016/0359 (COD).

[176] The absolute priority rule requires that dissenting classes of creditors receive full repayment before any junior creditor classes or equity classes receive payment under the plan.

[177] Article 9, Article 10(2).

[178] See proposed Article 373(2) of the *Bankruptcy Act 1896* (NL) ('extra-judicial composition'); Jochem Hummelen, 'A response to the financial crisis: recalibration of bankruptcy law' (2014) 11 *International Corporate Rescue* 297. An unofficial English translation of the Bill is available from <http://www.debrauw.com/draft-bill/#>.

business operations and for funding corporate restructuring. England has raised the prospects of introducing cross-class cram down and will likely follow European Union member states in doing so in order to keep its place as a global restructuring hub. Singapore is aggressively seeking to further develop itself as a restructuring hub in Asia.

As more jurisdictions introduce reforms to facilitate financial restructuring, it is likely that cross-class cram down mechanisms will become accepted as an important feature of modern restructuring legal frameworks. The value of cross-class cram down mechanisms is recognized in the European Commission's draft recommendation on business rescue and has been recognized in other forums.[179]

Australian laws and the Australian judicial system are widely respected around the world. Our financial system and expertise in managing financial transactions is also widely respected. Many Australian financiers, lawyers, accountants and other restructuring professionals have experience working overseas and are widely sought after in the global employment market. However, expertise can only go so far in maintaining an efficient insolvency and restructuring framework. The law needs to meet the expectations of international investors and give them confidence to invest in local restructuring efforts.

Australia needs to recognize that it is involved in a global market place for restructuring capital. By relying on procedures that date back to the 1800s as a major restructuring tool we risk falling behind, not only the leading restructuring hubs of New York and London, but falling behind European member states and those in our own region: China, Japan and Singapore, all of which have cross-class cram down mechanisms. Australia needs to add such a tool to our legal framework to support restructuring efforts, particularly given the increasingly prominent role that foreign distressed debt and special situation funds play in major restructurings. Recent large scale restructurings in Centro, Nine Entertainment, Fitness First, Billabong, Boart Longyear, Atlas Iron, Mirabela Nickel, Emeco, and Boart Longyear all involved offshore specialist funds in leading roles during the restructuring. These investors come from jurisdictions (particularly from the US) that use cram down to provide corporate rescue and restructuring. Introducing a cross-class cram down mechanism in Australia will help bring our law into line with international standards and will facilitate the restructuring and rescuing of distressed companies using creditors' schemes of arrangement.

In advocating for the introduction of a cross-class cram down mechanism in Australian law it is recognized that the rights of those crammed down also need consideration and need to be treated fairly. This can be achieved by following the example set by overseas jurisdictions such as Singapore and the United States. However, it is not recommended that Australian follow the lead of Singapore and largely adopt the US provisions, which have their own historical features that fit within their legal and administrative framework. For example, Singapore's adoption of the 'indubitable equivalent' standard for protection of secured creditors could be highly problematic to implement given the lack of consistency in the United States bankruptcy court system as to what will be sufficient to meet that standard.

First, it is important that the priority of secured debt over unsecured debt be recognized and that the property rights of secured creditors (as distinct from their rights *in personam* under their debt contracts) not be confiscated without adequate

[179] See for example, the report by AFME, Frontier Economics and Weil, *Potential economic gains from reforming insolvency law in Europe*, February 2016, p5; World Bank, *Principles for Effective Insolvency and Creditor/Debtor Rights Systems* (2015), Principle C.14 (recommending court approval of a reorganization plan based on majority voting).

compensation. It is recommended that any cross-class cram down mechanism adopt a form of absolute priority rule whereby secured creditors must be paid before junior unsecured creditors or equity are paid, which would need to fit within the existing priority regime given to employee entitlements under the *Corporations Act* s 433 and s 561. The absolute priority rule would be applied throughout the capital structure so that mezzanine lenders would be paid prior to general unsecured creditors and equity and so forth. However, the absolute priority rule could be set as a relevant consideration for the court to consider, to leave open the possibility that an effective restructuring may need to pay junior creditors such as essential suppliers or equity in order to promote a successful enterprise going forward. Of course, it would still be possible to exclude certain categories of creditors or equity where their legal rights are not affected by applying the *Tea Corp*.[180]

Second, creditors under a cram down reorganization plan must be paid at least the equivalent of what they would receive in a likely liquidation of the company. This is consistent with the assessment of fairness of deeds of company arrangement that may follow a period of voluntary administration by the court on applications to terminate the deed because of unfair prejudice.[181]

Third, cram down should only be available by court order, not by the mere majority vote of the creditors. Furthermore, the court should only order cram down where the class votes represent a majority in favour of the scheme overall (across all classes), being a majority that is at least 75% of the value of the debts and claims owed. The court should retain the discretion that it currently has under s 411(4) of the *Corporations Act*, which is to ensure that:

a) the terms of the statute have been complied with in conducting the creditor meetings;
b) the classes were fairly represented by those who attended the meeting and that the majority were acting bona fide and not oppressing the minority; and
c) the arrangement is such as an intelligent and honest person, if a member of the class concerned and acting within their interests, might reasonably approve.

By giving affected creditors the opportunity to oppose the scheme at the second court hearing (which is currently permitted), this provides an important safety net to ensure that the cram down is not unfairly prejudicial or oppressive.

In the near future, cross-class cram downs could form part of restructuring laws around the globe: from the United States to England, much of Europe and stretching into the Asia Pacific region in Singapore, China and Japan. It is important for Australia's restructuring laws to meet international best practice to ensure that we remain an attractive destination for the global flow of funds for restructuring deal flow. A cross-class cram down should be introduced into Australian law.

VII Conclusion

This article has argued that the current requirement to place creditors in separate classes for voting on schemes of arrangement can create inefficiencies and increase costs and complexity due to the requirement that each class approve the scheme.

[180] *Re Tea Corp Ltd* [1904] 1 Ch 12.
[181] See *Corporations Act 2001* (Cth) s 445D.

Changes in the secondary debt marks in Australia and the increasing role of hedge funds and debt traders buying up secured debt in Australian distressed companies creates fragmentation of lending groups which makes obtaining the necessary majority difficult as stakeholders jockey for leverage to extract maximum value. Debt trading poses risks for effective restructuring because debt traders may have little interest in saving a business rather than simply extracting their financial margin by being bought out. As noted above, some may even actively work against a successful restructuring due to their holdings of credit default swaps which pay out on liquidation.

The current law allows for greenmailing to occur where debt traders buy up strategic blocking stakes in a company's debt stack in order to pressure restructuring leaders to pay them off in order to secure approval of the scheme, even where the overwhelming majority of creditors support the scheme. This is a problem in many developed economies seeking to promote effective and efficient corporate restructuring and rescue laws and to minimize losing viable businesses to liquidation. Many foreign legal systems address the problem of greenmailing during restructuring by providing a cross-class cram down mechanism, usually by way of court order, provided that the majority of creditors support the restructuring proposal. While US bankruptcy law is perceived to lead the way on cram down mechanisms for restructuring, this article has shown that cross-class cram down mechanisms exist in many jurisdictions across Asia and are likely to become more common in Europe. Even the UK, whose laws provide the foundation for Australia's scheme laws, has suggested cross-class cram down may be introduced. In the author's view, class difficulties experienced in recent restructurings such as Nine Entertainment, Emeco, and Boart Longyear are a sign of things to come. If Australia wants to remain competitive as a destination for debt restructuring capital we must ensure that our laws provide an effective and efficient framework to support restructuring and a cross-class cram down mechanism would be a useful addition to our scheme of arrangement procedure.