

Pooling in Australian Corporate Insolvency

Recent amendments to the insolvency provisions of the Corporations Act 2001 (Cth) in Australia aim to address some of the practical problems faced by liquidators of corporate groups.

What is pooling?

Traditionally, "pooling" is a term used to describe a method of winding up an insolvent corporate group as if it were a single corporate entity.

In legal terms, it has been defined as:

"the unified administration of various companies ... including combining their assets and liabilities as if in one company, treating the creditors of all the companies as if they were creditors of that company"¹

Until this year, the Corporations Act 2001 contained no provisions actually authorising pooling of companies in winding up. This required liquidators to obtain Court approval for pooling arrangements based on creative uses of various bits and pieces of the Act.² That approval was by no means a certainty.

Why pooling?

Liquidators tend to cite two reasons for putting forward a pooling proposal:

- the costs that can be saved from administering the group and its creditors as a single entity;
- the contention that the group companies' records have been so poorly maintained that it is extremely difficult, if not impossible, to determine which company in the group owes money to which creditors.

These reasons were often relied upon together in applications for Court approval

¹ Rehabilitating large and complex enterprises in financial difficulties, Corporations and Markets Advisory Committee Report, October 2004, p 93.

² See, for example, *Re The Black Stump Enterprises Pty Ltd and Associated Companies* [2005] NSWCA 480; *Tayeh and De Vries re The Black Stump Enterprises Pty Ltd & Ors* [2005] NSWSC 475; *In the matter of Ansett Australia Limited (ACN 004 209410) [2006] FCA 277*; *cf Dean-Willcocks & Anor re Alpha Telecom (Aust) Pty Limited & Anor* [2004] NSWSC 738; *Switch Telecommunications Pty Limited (in liq) & 1 Ors*; *ex parte Steven John Sherman and Peter Murray Walker* [2000] NSWSC 794; *Whittingham re Hunter Valley Gravel Supplies Ltd & Ors* [2006] NSWSC 1070.

The amendments

The Corporations Amendment (Insolvency) Act 2007 establishes a type of pooling regime for companies in liquidation. I say "type of pooling arrangement" because, strictly speaking, it is not "pooling" as that term has traditionally been used (as reflected in the quotation above). In the consultation period leading up to the introduction of the amendments into Parliament, the Government explained why it did not want to legislate for what might be termed "traditional" pooling arrangements:

"4.220 The proposed model under new Division 8A of Part 5.3A does not introduce the concept of one group (or one economic entity) replacing the particular companies that comprise the group to be pooled. It does not treat the creditors of all the companies as if they were creditors of that group (or economic entity)

4.221 The introduction of a 'single economic entity' concept would require extensive amendments to the Corporations Act. The Corporations Act does not include the concept of a corporate group as a distinct legal entity. The concepts of holding, subsidiary and related companies and parent and controlled entities are based on the notion of each company being a separate legal entity."³

Instead, the Government and Parliament have opted for a regime in which each company in the group will be liable for the debts of all the other companies in the group (with mutual extinguishment of intra-group debts).

(This aspect of the amendments does, of course, raise one interesting question: will there still be scope for "traditional" pooling arrangements? As noted above, "traditional" pooling arrangements rely upon the Courts' willingness to endorse an ad hoc proposal relying upon various statutory provisions that were never intended to support pooling. Given that there is now a statutory pooling regime of sorts, the Courts' traditional hesitation over "traditional" pooling may harden. On the other hand, experience with the new regime may reveal that it suffers from some practical problems, which may force liquidators to follow the "traditional" path.)

Pooling will not apply to secured creditors.⁴

³ *Explanatory Statement To The Exposure Draft Of The Corporations Amendment (Insolvency) Bill 2007*, November 2006.

⁴ S 571 and 579E.

Pooling mechanism

The amendments provide for two types of pooling: voluntary and court-ordered. As I will explain, the difference is more apparent than real, because the two types will often simply be different points along a timeline.

A pooling "determination" will require a separate vote of approval by the creditors of each company in the group. In each case, the approval must be given by creditors representing at least:

- * 75% of the debts claimed by creditors at the meeting; and
- * 50% of the creditors voting at the meeting.⁵

If the necessary approvals are received from each company in the group, the determination will come into operation immediately after the last vote is held.⁶

The determination only comes into effect if it secures the necessary approval of all of the meetings: a failure to achieve the required majorities at just one meeting is fatal.

This ability of one company's creditors to defeat a pooling determination will be of crucial importance if it is clear that pooling would disadvantage one group of creditors. Unless the group's records have been destroyed or are completely unintelligible, it will usually be evident that payments to creditors will vary from company. A pooling determination would effectively remove those differences, with the result that some companies' creditors would receive more and others less than would be the case if there were no pooling determination. Creditors who would thereby be disadvantaged by pooling might therefore decide to vote against it; they would be aided in this by the high value voting threshold.

Failure to achieve a creditor vote is not the only hazard that a pooling determination will face. Individual creditors will be able to challenge pooling in court.⁷ On application by a creditor, a court will be able to terminate a pooling determination on a number of grounds, including:

- * it was approved by creditors on the basis of materially misleading information;
- * it would "materially disadvantage" the dissentient creditor;
- * it would be contrary to the interests of the group's creditors as a whole.

⁵ S 577.

⁶ S 578.

⁷ S 579A.

Given that these are quite wide grounds, many liquidators may be tempted to skip the whole pooling determination procedure and go straight to court for a court-imposed pooling order (the second form of pooling under the amendments).

The Court will have a wide discretion on whether to make a pooling order. In general terms, that discretion is similar to its discretion on whether to terminate a pooling determination, with some added factors for the Court to take into consideration:

- the extent to which a company in the group and the officers or employees of a company in the group were involved in the management of any of the other companies;
- the conduct of a company in the group and the officers or employees of a company in the group towards the creditors of any of the other companies;
- the extent to which the circumstances that gave rise to the winding up of any of the pooled companies were attributable to the actions of any of the other companies in the group or the officers or employees any of the other companies in the group;
- the extent to which the business of the pooled companies has been intermingled;
- the extent to which creditors of any one or more of the pooled companies may be advantaged or disadvantaged by the making of the pooling order.⁸

Issues

Because these amendments are quite new, they have not yet been put into practice. It is, therefore, premature to say whether or not they will prove successful.

A major issue for pooling is that it almost always creates winners and losers among creditors. The winners will be those who will gain access to the assets of group companies other than the company with which they have a debtor-creditor relationship. On the other side of the coin, the losers will be those whose pool of available assets is suddenly thrown open to all creditors of the group.

The Government's original draft proposal for pooling would have required liquidators to obtain court approval once a creditor objected to the pooling proposal (ie, once a creditor objected, the onus of getting court approval would lie on the liquidator). Insolvency practitioners pointed out that this would quickly render the pooling provisions a dead letter. The Government's response has been to place the onus on dissentient creditors, by requiring them to launch a court challenge to the pooling proposal. Given that many creditors have only very relatively small debts, the costs of mounting a court challenge (and the highly discretionary nature of the Court's power) will be a strong disincentive to such challenges.

However, liquidators also face problems under the new regime. Effectively, they will have a choice between a meeting of creditors with high voting thresholds (and the risk of a court challenge) and the

⁸ S 579E.

risks and costs of applying for court approval. Either way, pooling will not necessarily be an inexpensive option, suggesting that it would only be an economic proposition in relatively large and complex group liquidations, where the cost saving of pooling would offset the initial set-up costs.

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