

INSOLVENCY LAW SUMMARY



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Sample

Topic 1. Overview and Theory

1.1 Types of Insolvency

There are two types of insolvency:

- A. Personal insolvency, which is regulated by the *Bankruptcy Act 1966* (Cth); and
- B. Corporate insolvency, which is regulated by Chapter 5 of the *Corporations Act 2001* (Cth).

This law summary is concerned with corporate insolvency and all references to legislation are made to the *Corporations Act 2001* (Cth) unless otherwise indicated.

Topic 10 primarily deals with the *Bankruptcy Act 1996* (Cth).

1.2 The Insolvency Process

- Insolvency is concerned with a process:
 - A. Appointment
 - What type of appointment has been made?
 - Receivership, voluntary administration, liquidator (what type of “insolvency practitioner”)?
 - Has this appointment been validly made?
 - B. Investigation
 - What is the effect of the appointment in relation to the powers of the insolvency practitioner?
 - Have the directors engaged in insolvent trading or entered into voidable transactions?
 - C. Meeting / Priorities / Payments
 - Who are the creditors?
 - Has there been a valid meeting?
- Hence, in problem questions, the following questions need to be asked:
 - What type of appointment has occurred?
 - What is the stage of the insolvency process?

1.3 Insolvency Theory

1.3.1 The “Creditors Bargain” Model

- Basic corporate law theory is primarily influenced by the shareholder primacy model whereby the board of directors is accountable to the shareholders

because the shareholders are the primary stakeholders. However, where the company becomes insolvent, the shareholder primacy model becomes redundant and the “creditors bargain” model becomes relevant.

- The creditors bargain model is based on the notion that insolvency is a fact as opposed to an issue of morality. It asserts that there should be a stay of proceedings amongst the creditors of an insolvent company in order to preserve the pool of assets so that there can be an equitable distribution amongst the creditors (the ‘*pari passu*’ principle). Where there are secured creditors (who hold rights in rem) and unsecured creditors (who hold rights in personam), this model recognises these priorities such that secured creditors are paid out before unsecured creditors.

1.3.2 *Distributional Theory*

- The disadvantages associated with the creditors bargain model come to light when consideration is given to employees and tort claimants who may become potential creditors of an insolvent company. Such creditors have limited bargaining power in relation to obtaining a secured charge over the company and, hence, the creditors bargain model operates to their disadvantage. In recognition of this disadvantage, distributional theories have emerged which assert that insolvency is a social problem and should be treated accordingly. Furthermore, insolvency is an opportunity to redistribute wealth amongst society such that employees and tort claimants should be given priority over secured creditors. This is in line with the theory of ‘communitarianism’ which holds that insolvency should extend beyond the creditors to the community at large.¹

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¹ C Symes and J Duns, *Australian Insolvency Law* (LexisNexis Butterworths, 2009) [1.4.2].