Doing Business in Australia - Distressed Debt and Special Situations

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Practical insights into Australia's distressed debt and turnaround investment landscape

Consultation at no cost
Company directors and advisors are welcome to call David Levi on **+61 418 602 466** for an initial consultation that will not incur a fee. Training for advisors in relation to these and other topics can also be arranged via videoconference.
Levi Consulting services all Australian States and Territories.

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Distressed Investing in Australia

This guide provides a practical overview of distressed investing and special situations in Australia. It explains how investors, lenders and advisors can identify opportunities, manage risk and deploy capital effectively when businesses are under financial pressure or operating in complex circumstances.

Topics include distressed M&A, debt investing, enforcement strategies and transaction execution, both outside and within formal insolvency processes. The guide outlines the legal, regulatory and commercial considerations that influence outcomes and shape deal structure in the Australian market.

Our aim is simple — to help capital providers and stakeholders move with clarity and confidence, make informed decisions, and achieve better commercial results in time-sensitive and often uncertain situations.

For those focused on the operational side, our companion guide, **Doing Business in Australia – Restructuring & Insolvency**, provides a practical overview of Australia's restructuring and insolvency framework. It explains the options available when businesses experience financial distress, including informal workouts, safe harbour, small business restructuring, voluntary administration, deeds of company arrangement, receivership, liquidation and schemes of arrangement. It is designed to help directors, owners and advisors understand how the system works and act early to preserve value.

These guides provide general information only and are not a substitute for professional advice tailored to your specific circumstances.

David Levi is the Founder and Director of Levi Consulting, based in Sydney, Australia, with over 30 years' experience helping businesses, investors and advisors navigate restructuring, turnaround, insolvency and special situations.

Email dlevi@leviconsulting.com.au
Web www.leviconsulting.com.au
Linked in www.linkedin.com/in/davidlevi1/

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1. Distressed M&A and debt investing outside of formal processes

1.1 Are there specific legal requirements that apply for purchasing distressed equity in Australia?
In Australia, there is no specific legal regime governing the purchase of distressed equity. Key regulators, including the Australian Competition and Consumer Commission (**ACCC**), the Foreign Investment Review Board (**FIRB**) and the Australian Securities and Investments Commission (**ASIC**) apply their mandates equally to both distressed and non-distressed equity acquisitions.

For instance, section 50 of the *Competition and Consumer Act 2010* (Cth) states that a person must not acquire shares or assets if the acquisition would substantially lessen competition in any market for goods and services in Australia. Additionally, the FIRB serves several key functions under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**). These include the examination of proposed investments that fall within the scope of FATA, as well as assessing foreign investment proposals, including those involving distressed assets to ensure alignment with Australia's national interests. Market participants must consider these regulatory constraints when acquiring distressed businesses and assets, outside of formal insolvency processes.

1.2 Is there a special legal regime to purchase distressed debt or non-performing loans in Australia?
Australia does not have a dedicated legal regime for the purchase of distressed debt or non-performing loans (**NPLs**). However, general legal and regulatory frameworks apply to such transactions. These include contract law principles, the *Personal Property Securities Act 2009* (Cth) (**PPSA**), and prudential standards enforced by the Australian Prudential Regulation Authority (**APRA**). Generally, the banking, competition and prudential regulations will apply to regulated entities that are engaged in these transactions and will aim to address considerations such as risk management and proper disclosure principles.

Prudentially regulated entities – such as banks, credit unions, building societies, insurance providers and superannuation funds – must comply with APRA's prudential standards, including those relating to credit risk management. For example, APRA's Prudential Standard APS 220 outlines requirements for managing credit risk, including the treatment of impaired assets and the need for appropriate provisioning. Adherence to these standards assist in regulating risk retention, particularly when the objective of an NPL transaction is to obtain capital relief. There are strict time-based and quantum limitations on representations, warranties, and indemnities associated with the sold assets.

1.3 Other than regulatory requirements for specific industries in Australia? What are the general regulatory requirements that need to be considered in the case of distressed investments?

While only a relatively small percentage of the Australian workforce is unionised, trade unions continue to play a significant role in industrial relations. Under the *Fair Work Act 2009* (Cth), unions have rights to represent their members, including during enterprise bargaining and in matters concerning workplace conditions. In the context of distressed investments, unions may engage with restructuring professionals to advocate for employee interests, particularly in industries with a history of successful restructuring, such as manufacturing, mining, construction and airlines.

Additionally, Australia's federal structure means that regulations exist at both federal and state level. For example, in distressed real estate investments, there is significant regulation at the local government (municipal) level. Investors should be aware of these multi-layered regulatory requirements when engaging in distressed investments.

1.4 What risks exist for an investor of a distressed business in Australia?

Australia is generally regarded as a creditor-friendly jurisdiction, with robust institutions and an insolvency law framework that supports investment. However, investing in a distressed business carries specific risks, both within and outside the insolvency context.

1.4.1 What risks exist for the transaction to be challenged and overturned outside of bankruptcy in Australia?

Outside formal insolvency processes, transactions may still be subject to challenge under general legal principles. For instance, a transaction may be vulnerable to legal challenge if it:

- is not properly authorised;
- is not conducted at arm's length; or
- breaches third-party contractual restrictions.

Ensuring that transactions are properly documented, authorised through appropriate corporate governance processes, and conducted on commercial terms, can mitigate these risks including use of Australian based specialist professionals in law, accounting and insolvency.

Identification of the risks of challenge in a distressed investment scenario is foreseeable, through the lens of a possible subsequent post transaction formal insolvency challenge such as voluntary administration or liquidation.

1.4.2 What risks exist for the transaction to be challenged and overturned in subsequent formal bankruptcy proceedings in Australia?

In Australia, the term "bankruptcy" is largely used only in the personal insolvency context. For consistency, we will generally refer to "insolvency" rather than "bankruptcy".

Under Chapter 5.7B of the *Corporations Act 2001* (Cth) (**Corporations Act**), certain transactions entered into within a specified period before liquidation can be voided by a liquidator. These include unfair preferences, uncommercial transactions, unreasonable director-related transactions, insolvent transactions and creditor-defeating dispositions.

Relevant to this is the "relation-back" period, which determines the timeframe during which transactions may be scrutinised. For example, uncommercial transactions may be voidable if entered into within 2 years before the relation-back day, or 4 years if a related entity is involved. Transactions intended to defeat creditors can be voided if entered into within 10 years before the relation-back day. The relation-back day itself varies depending on the circumstances, such as the date of the winding-up application or the appointment of an administrator.

It is therefore imperative for transactions conducted close to insolvency to be documented, with clear evidence of fair value exchange and consideration of stakeholder rights to withstand later scrutiny should a liquidator be appointed. Failure to do so may result in the transaction being set aside, leading to potential financial loss and reputational damage.

1.4.3 What risks exist for a new lender investing in a distressed business in Australia?

A new lender to a distressed business assumes the financial risk of the investment, including potential loss of capital or income. Additionally, lenders must be cautious of "shadow director" liability. If a lender exerts significant influence over the company's decisions, they may be deemed a shadow director and be subject to the same duties and liabilities as formally appointed directors, including liability for insolvent trading under section 588G of the Corporations Act. Australian courts have recognised this doctrine, but have emphasised its exceptional nature. Lenders should avoid interfering with the company's management to mitigate this risk.

Directors, including shadow directors, have a duty to prevent the company from trading while insolvent. Insolvent trading occurs when a company incurs debts while insolvent, and directors may be held personally liable if they fail to prevent this. Defences to insolvent trading claims include having reasonable grounds to expect solvency, reliance on competent advice, taking reasonable steps to prevent the debt, and the "safe harbour" defence, which protects directors developing a course of action reasonably likely to lead to a better outcome for the company.

1.4.4 What risks exist for a new shareholder investing in a distressed business in Australia?

New shareholders in a distressed business may face similar risks to lenders, particularly if they appoint directors to the company's board. Appointed directors are subject to the same duties and liabilities, including the prohibition against insolvent trading. To mitigate these risks, directors should ensure that they can rely on one or more defences to insolvent trading, such as the safe harbour provisions.

The safe harbour provisions, introduced in 2017, offer some but not complete protection to directors from civil liability for insolvent trading if they are developing or implementing a course of action reasonably likely to lead to a better outcome for the company than immediate liquidation. To rely on this defence, directors must ensure that:

- The course of action is documented and based on reasonable assumptions.
- The company continues to pay employee entitlements and comply with tax reporting obligations.
- The debts incurred are in connection with the course of action.

Further, it is to be noted that the safe harbour does not protect directors from other legal obligations, and it does not prevent the appointment of an insolvency practitioner by a third party during the safe harbour period.

2. Enforcement Processes

2.1 What enforcement processes are available to distressed debt investors and M&A investors in Australia?

Distressed debt and M&A investors in Australia may avail themselves of several enforcement and restructuring mechanisms, including the following.

- **Receivership** – typically initiated by secured creditors under a registered security interest. A receiver is appointed to realise assets and repay the secured debt.
- **Voluntary administration (VA)** – a formal process where an administrator takes control of the company to assess options for restructuring leading to a Deed of Company Arrangement or winding up. Appointment of a VA can be by a majority of directors or by a secured creditor holding security over all or substantially all of the assets of a company.
- **Statutory demand** – a formal demand for payment of debt that can lead to court-ordered liquidation if unpaid.
- **Share pledge enforcement** – enables the creditor to sell or transfer pledged shares under security arrangements.
- **Court and non-Court processes** - includes notices and demands issued by Australian Taxation Office which have the effect of making directors liable for tax debt – garnishee orders, writs of possession, and foreclosure actions may be used, director penalty notices. Forced public or private sale options are available arising from the appointment of a receiver or liquidator or voluntary administrator, or court order depending on the nature of the secured asset. Public sale is common for assets like real estate or listed securities. It offers transparency and helps meet the duties under section 420A of the Corporations Act. Private sale is sometimes permissible where market value can be reliably established by independent valuation or a credible sales process.
- **Small business restructuring (SBR)** – SBR options also exist, but are only available to entities with liabilities below AUD$1 million.

2.2 What involvement does the court have in these processes in Australia?

Court involvement varies depending on the process.

- Voluntary administration and receivership – typically, these are private processes. Court involvement is optional but available to resolve disputes or validate decisions.
- Liquidation – court-ordered liquidations require formal applications and may involve frequent court oversight, particularly for disputes over voidable transactions, asset recovery or creditor claims.
- Schemes of arrangement – these require court approval at multiple stages.

2.3 How does the enforcement of a pledge on the shares of a legal entity work?

In Australia, a share pledge (commonly termed share mortgage or share security) creates a security interest over shares which are classified as Personal Property under the PPSA. To be enforceable, the security must be registered on the Personal Property Securities Register (**PPSR**).

The enforcement process includes:

- exercising contractual powers such as powers of attorney to effect sale or transfers;
- appointing receivers or taking possession of the shares; and
- complying with section 420A of the Corporations Act, which imposes a duty to take all reasonable care to sell the property for at least market value or the best price reasonably obtainable having regard to the circumstances when the property is sold (provided there is no market value).

2.3.1 Is it possible to implement a debt-for-equity swap as part of a share pledge enforcement?

Yes. However, the enforcing party must comply with the duties in section 420A of the Corporations Act. This typically involves conducting an open sale process to establish market value, and the creditor may credit bid their debt in lieu of cash.

Alternatives include:

- A creditors' scheme of arrangement (Part 5.1 of the Corporations Act) – financially distressed companies are allowed to propose restructuring plans, including debt-for-equity swaps, which requires court approval and creditor support.
- A deed of company arrangement (**DOCA**) – another avenue for distressed companies to arrange with creditors, potentially including debt-for-equity swaps if agreed by creditors during voluntary administration.
- Foreclosure – a rarely used but legally possible remedy.

2.3.2 Is a public auction mandatorily required or are private sales possible?

In Australia, enforcement sales can be conducted through either a public auction or a private sale. Public auction is not a mandatory requirement, but if the secured asset in question is one which would more typically be sold through public auction in a non-distressed scenario then a public auction would typically be used to satisfy mortgagee duties unless there were commercial reasons for an expression of interest campaign or similar. Regardless, it is usual for there to be an open process at the outset, even if truncated or leading to a private sale. Private sales are permitted, provided the sale process demonstrates reasonable care in achieving market value.

2.3.3 Is it possible to set aside transfer restrictions in the constituent documents of a legal entity as part of a share pledge enforcement?

Generally, no. When debtors pledge shares as collateral for a loan in Australia the secured creditor gains a security interest in those shares and can sell them if the debtor defaults. However, transfer restrictions outlined in constituent documents, such as pre-emptive rights, director approval, tag-along and drag-along rights, lock-up periods, prohibition on encumbrance, and right of refusal, can complicate this process. A secured creditor enforcing over shares will be bound by the same restrictions to which the grantor of the pledge is bound.

Accordingly, it is important to diligence these aspects at the outset and where required seek amendments to any relevant restrictions.

2.3.4 Is "market testing" mandatorily required?

Market testing is not mandatory but it is an important consideration for controllers, such as receivers or managers who are tasked with selling property of a corporation with a discernible market value, as required under section 420A of the Corporations Act.

This requirement obligates controllers to ensure that the sale price does not fall below the property's market value, aiming to protect the corporation and its stakeholders from undervalued sales.

2.3.5 Are valuation reports mandatorily required?

No, but they are routinely obtained in practice. While valuation reports are not always mandatorily required, they play a critical role in upholding transparency and fairness during share transfers and provide some protection to secured creditors and insolvency professionals against breach of duties claims. For example:

- Section 420A of the Corporations Act addresses the obligations of Controllers (including receivers and mortgagees in possession) of property regarding the sale of secured assets for an amount not less that the market price or otherwise the best price reasonably obtainable in the circumstances. Valuation reports are often commissioned to support decisions to execute a sale.
- Section 444GA of the Corporations Act pertains to share transfers in companies under administration, permitting transfers as part of a DOCA. When approving transfers under section 444GA, valuations will be critical.
- With schemes of arrangement, ASIC will typically mandate certain conditions providing shareholders with explanatory materials, including an Independent Expert Report (**IER**) prepared on a non-going concern basis, demonstrating that shareholders have no residual equity in the company based on a liquidation value assessment, and ensuring the independence of the expert preparing the report.
- Valuation reports help mitigate liability for breaches of duty and enhance transaction defensibility.

3. Pre-Insolvency Processes

3.1 What pre-insolvency processes are available to distressed debt and M&A investors in Australia?

For large corporates and M&A the preference is often Scheme of Arrangement under Part 5.1 of the Corporations Act, which is a court-approved statutory agreement between a company and its shareholders and creditors or class of them. Schemes of arrangement are also utilised in non-distressed public M&A processes as they offer greater flexibility compared to takeover bids and are supervised by both ASIC and the courts. However, schemes are expensive and typically reserved for large, cooperative restructurings.

Other available pre-insolvency options include:

- Informal workouts – negotiated consensual restructurings outside formal court processes.
- Safe harbour restructuring – directors can rely on safe harbour protections when developing restructuring plans.
- Refinancing or standstill arrangements – negotiated debt extensions or capital injections without court involvement.

3.2 What involvement does the court have in these processes?

Court involvement in schemes of arrangement begins at the initial directions hearing to approve the meeting convening process and continues through to the final hearing for scheme approval. The court will scrutinise class formation, disclosure adequacy, procedural fairness and compliance with statutory voting thresholds. The court's role concludes after final orders and any ancillary relief is granted.

There is minimal or no role for court involvement for the other pre-insolvency options unless a dispute arises, or directions of the court are needed.

3.3 Who are the main players in these processes and are there any court-appointed insolvency Practitioners in Australia?

The main players may include all or some of the following.

- Company directors and management or secured creditor initiates the restructuring.
- Legal, accounting and insolvency advisors (registered liquidators) - support plan development and Disclosure, evaluate a company's viability, conduct root cause analyses and devise turnaround or winding-up strategies if necessary.
- Valuation experts - assess business and asset values, guiding decisions on asset sales, mergers, or reorganisation based on fair market values and recovery potential.
- Restructuring specialists - specialise in crisis management and provide strategic guidance on restructuring, financial recovery and operational enhancements to bolster distressed companies.
- Insolvency practitioners - may be appointed by the court as scheme administrators or oversee implementation. The appointment of insolvency practitioners is typically achieved by agreement with the company, though court orders may formalise their role, especially where disputes or objections exist.

3.4 Is there a typical due diligence process followed?

Due diligence is market-standard but not court-imposed. In schemes of arrangement, the target company prepares a scheme booklet with financial and strategic disclosures, reviewed by ASIC and the court. Independent expert reports are often included. Distressed investors are increasingly conducting thorough diligence, particularly where capital structure complexity or regulatory risks exist.

3.5 What is the typical timeline of an M&A sale under a pre-insolvency process and how does the process work?

A scheme of arrangement process typically spans 4 to 6 months. Key steps include:

- Commercial negotiations and signing of scheme implementation agreement.
- Drafting scheme booklet and IER.
- ASIC review of documents.
- First court hearing (directions) and subsequent hearings if required.
- Shareholder or creditor meetings (with 75% in value and 50% in number approval).
- Final court hearing for approval.
- Lodgement with ASIC and implementation.

3.6 Are M&A sales and asset sales protected under the pre-insolvency processes in Australia?

Not inherently. Asset sales effected under pre-insolvency processes may still be reviewed under voidable transaction provisions if a formal insolvency follows. However, sales implemented under a court-approved scheme of arrangement are generally considered defensible if they occur at fair value.

The "relation-back" period discussed above determines the look-back period for scrutinising such transactions.

3.7 Are “pre-pack” processes - pre-packaged restructuring plans - permitted and how do they work?

Yes. Pre-packs can be implemented through:

- Schemes of arrangement – pre-agreed between creditors and / or shareholders and then formally approved by court.
- DOCAs – entered into post voluntary administration, often negotiated before appointment.
- Voting lock-up agreements – may be used, but statutory timelines must still be followed.

4. "Pre-Pack" Sales

4.1 Are "pre-pack" sales - pre-packaged sales of all or parts of the business - permitted in Australia and how do they work?

Pre-pack sales are permitted but not formally codified. Typically, assets are sold either prior to or alternatively shortly after a voluntary administrator, liquidator or receiver is appointed. This minimises business disruption and maximises value preservation. Transactions may be exchanged and settled pre-appointment or alternatively, exchanged pre-appointment and settled after appointment. The insolvency practitioner for reasons of independence cannot be involved in both sides of the transaction and an independent specialist is needed for the pre-appointment phase, usually a specialist insolvency lawyer supported by accounting advisors and valuers. Transmission and sale of assets, and pre-pack sales generally must be transparent, well documented by a specialist insolvency lawyer as a sale and purchase, at fair market value, and include a valuation.

Pre-packs require transparency and valuation support to avoid accusations of "phoenixing". Anti-phoenixing laws like *Treasury Laws Amendment (Combating Illegal Phoenixing) Act 2020* (Cth) penalise asset transfers without proper consideration. Also, Corporations Act legislation prohibits creditor defeating transactions.

4.2 Who are the main players in these processes and are there any court-appointed insolvency practitioners?

The key players include:

- Directors and shareholders – often initiate the pre-pack process.
- Insolvency practitioners (registered liquidators) and also specialist insolvency lawyers – appointed privately.
- Creditors – may approve or challenge the sale, when known.
- Regulators – ASIC and the Australian Taxation Office play a monitoring role.

Insolvency practitioners must act independently, even if their appointment was pre-agreed.

4.3 Can M&A or debt investors influence the appointment of insolvency practitioners?

Yes, in most cases, insolvency practitioners are privately appointed and their appointment can be influenced by key stakeholders. However, once appointed, they owe duties to all creditors and are subject to statutory and professional obligations.

4.4 Is their special protection for certain types of creditors in "pre-pack" sales?

Yes. Employee entitlements are priority claims under the Corporations Act and their rights and entitlements must be preserved. Tax authorities do not have statutory priority but possess powerful recovery tools including personal liability of directors, garnishees, and director penalty notices.

4.5 Is there a typical due diligence process followed?
Due diligence varies depending on the identity of the buyer. Market testing and valuation are essential. In related-party transactions, diligence may be more limited but still expected to meet minimum transparency and valuation standards.

4.6 Is "market testing" mandatorily required?
No, but it is best practice. If the sale is affected by a controller or administrator, there is a statutory duty to obtain market value. Limited testing or competitive tension should be documented.

4.7 Are valuation reports mandatorily required?
Not legally required, but almost always obtained to support the sale price and mitigate liability risks.

4.8 What is the typical timeline of "pre-pack" sales?
Timeframes may vary depending on the asset type, regulatory approvals and whether creditor approval is needed.

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12. Support from Levi Consulting

As always, we remain available for discussion virtually or face-to-face. Reach out to David Levi at +61 418 602 466 for a confidential conversation about your unique circumstances.

	Option	When is it suitable?
1	Informal Workout	Whenever informal solutions with creditors are feasible.
2	Members' Voluntary Liquidation, alternatively, corporate simplification	Solvent deregistration of a company that had trading activity.
3	Voluntary Deregistration	Solvent deregistration of a company with no or limited trading activity (e.g. a holding company or dormant company).
4	Voluntary Administration	Key mechanism for businesses in financial distress to explore restructuring or sale options while under the protection of a moratorium.
5	Safe Harbour	A support tool for enabling directors of a distressed company to continue to trade while working on an informal workout or planning for a formal solvency.
6	Deed of Company Arrangement (DOCA) following Voluntary Administration	A flexible, formal insolvency restructuring tool. It follows a Voluntary Administration. Widely suitable for restructuring debts.
7	Creditors' Scheme of Arrangement	Another flexible formal insolvency restructuring tool - more cumbersome to implement than a DOCA, but with the advantage of being able to bind secured creditors. Ideally suited to financial restructuring of large/complex debt stacks.
8	Small Business Restructuring Plan	For small and micro businesses (less than $1,000,000 in total debts) - a quick and straightforward alternative to a DOCA.
9	Creditors' Voluntary Liquidation	Best suited to a terminal liquidation of a failed/insolvent company - where an attempt at restructuring through administration and DOCA would be unlikely to work.
10	Court Liquidation	Effective in instances of shareholder/management failure (e.g. in a failed or dysfunctional joint venture). Also commonly used by creditors to attempt to force an involuntary liquidation on a debtor company that has failed to pay its debts.
11	Receivership	A receiver is appointed by the court or alternatively by a secured creditor to take control of all or part of the assets and business of a company or partnership. Court-appointed receivers are common for partnership disputes.
12	Section 66G	When co-owners are in a dispute over jointly owned property the court can appoint trustees using s 66G of the *Conveyancing Act 1919* (NSW) to sell the property and distribute the proceeds.

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