Business Bulletin

Information about Company Insolvency Options

BALDOCK STACY & NIVEN
Solicitors and Notaries

Helping you is our practice

In this Bulletin

- Introduction
- Voluntary Administration
- Deeds of Company Administration
- Liquidation
- Receivership

Introduction

There are several methods of rescuing businesses before they become formally insolvent.

If a company is in financial difficulty, it can be put under the control of an independent external administrator. The role of the external administrator depends on the type of external administration. Some of these are discussed in this Bulletin.

If your company is facing financial difficulties, it is important that you obtain legal advice from **Baldock Stacy & Niven** and from your financial advisors before it is too late. ❑

Voluntary Administration

Voluntary administration is designed to resolve a company's future direction quickly. An independent and suitably qualified person (the voluntary administrator) takes full control of a company to try to work out a way to save either the company or the company's business.

If this is not possible, the aim is to administer the affairs of the company in a way that results in a better return to creditors than they would have received if the company had been placed straight into liquidation. One way of achieving these aims is a Deed of Company Arrangement (which is discussed further below)

The voluntary administrator's role

The voluntary administrator's role after taking control of the company is to investigate and report to creditors on the company's business, property, affairs and financial circumstances, and on the three options available to creditors:

- end voluntary administration and return the company to the directors' control
- approve a deed of company arrangement through which the company will pay all or part of its debts and then be free of those debts, or
- wind up the company and appoint a liquidator.

The voluntary administrator must give an opinion on each option and recommend which option is in the best interests of creditors. The voluntary administrator has all the powers of the company and its directors. This includes the power to sell or close down the company's business or sell individual assets in the lead up to the creditors' decision on the company's future.

The directors' role

Directors cannot use their powers while the company is in voluntary administration. They must help the voluntary administrator, including providing the company's books and records, and a report about the company's business, property, affairs and financial circumstances, as well as any further information about these that the voluntary administrator reasonably requires.

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Shareholders and voluntary administration
A voluntary administrator is not required to report to shareholders. Shareholders do not get to vote on the future of the company. A transfer of shares in a company or alteration of status of shareholders during the voluntary administration will not be effective unless the court permits. ❑

Deeds of Company Arrangement

A Deed of Company Arrangement is one option available to creditors of a company placed in Voluntary Administration and cannot occur independently of a Voluntary Administration. A Deed of Company Arrangement is a binding agreement between the company and its creditors, which sets out how the creditors are to be paid (in whole or in part) and how the company is to be released from the claims of the creditors.

The details will vary between Deeds; it may involve a realisation of all assets, a compromise of all or some creditors' claims, the injection of new funds for distribution to creditors, or any combination of these. Ultimately, it is a flexible mechanism to enable an orderly resolution of the company's insolvency problems.

Where the creditors agree to a Deed of Company Arrangement, the Voluntary Administrator usually becomes the Deed Administrator. A Deed of Company Arrangement may include a compromise or moratorium on creditors' debts or a combination of them both. A Deed of Company Arrangement does not require Court approval and may be agreed to by a majority in number and value of creditors at a meeting held during the Voluntary Administration.

Points to note
The acceptance of the Deed of Company Arrangement binds all unsecured creditors, even if they did not vote in favour of the Deed. Secured creditors, landlords and owners will only be bound if they vote in favour of the Deed.

If the company defaults on the terms of the Deed, the Administrator of the Deed of Company Arrangement may call a meeting of creditors to terminate the Deed and place the company into Creditors' Voluntary Liquidation.

Where the company satisfies all of the requirements of the Deed of Company Arrangement, it will be released from the Deed and will no longer be subject to any formal insolvency administration (unless the Deed specifies that the company is to be placed into liquidation on termination of the Deed).

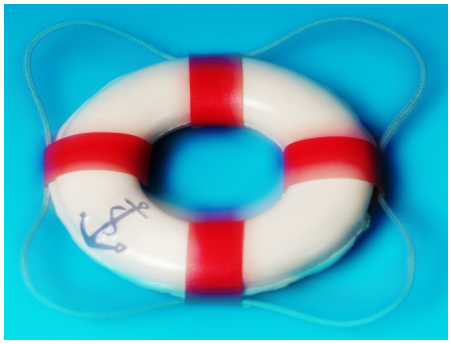
The *Corporations Act* governs the making, execution, performance, variation and termination of the deed. The Act leaves it to the parties as to what their deed contains and they are mostly free to draft a deed to suit their circumstances.

Persons bound
There must be a person to act as administrator of the deed. That person is often the person who acted as administrator, during the earlier phase of the company being "under administration". The deed also binds persons who were creditors at the time the company became "under administration". The officers and shareholders of the company are also bound by the deed.

Conditions precedent
It may be stated that the deed is not effective unless and until some event occurs. That could be:

- the sale of a particular asset (such as land) or a division of a business
- a contribution to the company of fresh working capital (as debt or share capital)
- the obtaining of a tax opinion on the company's position
- further investigations of the company's past or prospects
- anything else.

Executive power



The administrator assumes sole executive powers (to the exclusion of the directors) for the company "under administration". If the deed allows the directors to run the company, expect ancillary provisions:

- giving the administrator continuing free access to books, records and minutes
- forbidding certain corporate behaviour or entitling the administrator to be consulted about material transactions
- requiring periodic reports to the administrator
- committing the company to an agreed recovery plan.

Claims by creditors

Creditors' claims existing when the company went "under administration" may be:

- frozen for a time, before reactivation
- released in whole or in part
- satisfied by payment of some cents in the dollar (the usual choice) in which case:
  - creditors must "prove" their claims under the same rules as for a liquidation
  - the deed will identify the company assets available to satisfy the claims
  - if claims proved exceed the available assets, they rank for payment as they would in liquidation.

Activities of creditors

Once the creditors approve the making of a deed, their role should be reduced to:

- filing a proof a debt with the administrator and doing whatever they need to prove their claims
- receiving a dividend in satisfaction of their claims
- (for some of them) serving on any committee of creditors constituted by the deed whose function is to be consulted by the administrator
- (in a later creditors' meeting) if desired, resolving to vary or terminate the deed at any time. ❑

Receivership

A company goes into receivership when an independent and suitably qualified person (the receiver) is appointed by a secured creditor or, in special circumstances, by the court to take control of some or all of the company's assets.

If a receiver has, under the terms of their appointment, the power to manage the company's affairs, they are known as a receiver and manager.

The receiver's role

The receiver's role is:

- to collect and sell enough of the charged assets to repay the debt owed to the secured creditor
- if they have been appointed under a fixed charge (e.g. over land, plant or equipment), to pay out the money collected:
  - first, to pay the secured creditor, and
  - second, if there are any funds left over, to pay this surplus to the company or its other external administrator if one has been appointed
- if they have been appointed under a floating charge (e.g. over cash, debtors or stock), to pay out the money collected:
  - first, to pay priority claims (including certain employee entitlements)
  - second, to pay the secured creditor, and
  - third, if there are any funds left over, to pay the company or its other external administrator if one has been appointed, and
- to report to ASIC any possible offences or other irregular matters.

The directors' role
Receivership does not affect the legal existence of the company. The directors continue to hold office, but their powers depend on the powers of the receiver and the extent of the assets over which the receiver is appointed. Control of the charged property, which often includes the company's business, is taken away from them. Directors must provide the receiver with a report about the company's affairs and must allow the receiver access to books and records relating to the charged property.

Shareholders and receivership
The receiver's primary duty is to the company's secured creditor. The main duty owed to unsecured creditors and shareholders is an obligation to take reasonable care to sell charged property for not less than its market value or, if there is no market value, the best price reasonably obtainable. There is no obligation for the receiver to report to the shareholders on the progress or outcome of the receivership. ❑

Liquidation

There are two types of liquidation for an insolvent company: creditors' voluntary liquidation and court appointed liquidation. The most common type is a creditors' voluntary liquidation.

The liquidator's role
The liquidator's role is to:

- collect, protect and realise the company's assets
- investigate and report to creditors about the company's affairs, including any unfair preferences which may be recoverable and any possible claims against company's officers
- enquire into the failure of the company and possible offences by people involved in the company and report to ASIC
- after payment of the costs of the liquidation, and subject to the rights of any secured creditor, distribute the proceeds of realisation—first to priority creditors, including employees, and then to unsecured creditors, and
- apply for deregistration of the company on completion of the liquidation.

Except for lodging documents and reports required by law, a liquidator is not required to do any work unless there are enough assets to pay their costs.

The directors' role
Directors cannot use their powers after a liquidator has been appointed. They must help the liquidator, including providing the company's books and records, and a report about the company's affairs.

Shareholders and liquidation
The liquidator's primary duty is to all of the company's creditors. The shareholders rank behind the creditors and are unlikely to receive any dividend in an insolvent liquidation. In a court liquidation, the liquidator is not required to report to the shareholders on the progress or outcome of the liquidation.

In a creditors' voluntary liquidation, a meeting of shareholders must be held annually and a joint meeting of the creditors and shareholders must be held at the conclusion of the winding up.

The liquidator can call on the holders of any unpaid or partly paid shares in the company to pay the amount outstanding on those shares. If a liquidator makes a written declaration, that they have reasonable grounds to believe there is no likelihood that shareholders will receive any further distribution in the winding up, shareholders can realise a capital loss. ❑

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