MACKS ADVISORY

Voluntary Administration

Frequently asked Questions
ASIC Information Sheets

What happens if you call in the VA?

Accountants can assist the Administrator in the resuscitation of a company in a number of ways.

For example:-

- *Assisting the Administrator in formulating the proposal*
- *Assisting the Administrator in providing information to creditors*
- *In consideration of possible taxation implications of the proposal in the preparation of cash flow and financial information*

Appointing a voluntary administrator is like taking a time out whilst allowing you to consider all your options.

Here's how it works.

Appointment

The clock has begun ticking on the tight timetable set out in the *Corporations Act*. The VA steps in to:-

- *Ensuring business as usual:*
  In our experience the best result for creditors is achieved and is dependent upon the business continuing uninterrupted, one of the noticeable features leading up to a period of financial difficulty is the inability of management to concentrate on business decisions because of the various distractions caused as a result of the financial difficulties. Directors can now concentrate on business

- *Taking physical possession and meeting staff:*
  Explaining the reasons for the appointment and outlining his/her plans. Staff are reassured about their entitlements and encouraged to lend their support.

- *Insuring assets:*
  The level of insurance cover is reviewed. If existing insurance is inadequate or non- existence adequate insurance cover is taken out.

- *Obtaining independent valuations:*
  The going concern value and forced realisation value of the assets are assessed for assistance in planning and constructing a proposal acceptable to creditors and for the report as to affairs.

- *Supply is maintained:*
  Stock levels are reviewed and purchase orders are made in line with sales expectations.

- *Financial controls are reviewed:*
  If financial controls are inadequate adequate controls are introduced including the signing of all cheques, the opening of new company bank accounts, signing stock orders.

- *Unsecured creditors' position is frozen.*
  A moratorium is imposed on unsecured creditors and an unsecured creditor is unable to take action to enforce their debt.

Notifications

The VA notifies the Australian Securities and Investments Commission (ASIC), the company and any secured creditors within 2 business days of appointment. Although the directors powers are technically suspended during the period of the administration the role of the directors changes wherein he/she works in a co-operative manner with the Voluntary Administrator to formulate a proposal acceptable by the creditors. Directors are advised of their duties, the bank, landlord and any leasing companies are notified.

Within 3 business days, the VA must notify creditors in writing and by advertisement, of the first meeting of creditors. This meeting must be held within 8 business days.

First Creditors' Meeting

At the meeting the creditors have the power to appoint a creditors' committee and, if they wish, to replace the VA. The VA at this stage has just commenced his review of the company and is still examining the company's records and valuations, budgets and cash flows are still being prepared, however the VA endeavours to provide relevant information to the creditors as to the present financial position and the plans of the VA.

Report as to Affairs

A copy of the report as to affairs of the company is received by the VA. The VA can assist the directors in the preparation of this report.

Secured Creditors

While the claims of unsecured creditors are frozen during the period of administration, secured creditors are given 10 business days to decide whether to enforce their security by the appointment of a Receiver and Manager. If secured creditors do not take action within this 10 day period, they are prevented from doing so during the course of the administration.

The VA therefore needs to inform the secured creditor of the financial position of the company and the plans of the VA.

Report to Creditors

The VA must give notice of the second meeting of creditors by this day. The VA's report will consider whether:-

- the administration should end;
- it would be in the interests of creditors to execute a Deed of Company Arrangement; or
- it would be in the interests of creditors to wind up the company.

By this day, the VA has completed a large degree of the assignment and has worked out a broad plan that involves:

- continuing to trade;
- investigation;
- preparation of a reconstruction plan.

Second Creditors' Meeting

The second creditors' meeting must decide the company's future. The VA's report on the company's business, property affairs and financial circumstances is tabled, as are his/her recommendations. The key question is whether it is in the interests of creditors to execute a Deed of Company Arrangement.

Post appointment period

If a Deed of Company Arrangement is accepted, a number of statutory matters need to be attended to - the minutes of the meeting must be prepared and lodged with the Australian Securities Commission. The Deed needs to be executed, creditors notified, a copy lodged with the ASIC and creditors paid. Importantly, control is handed back to Directors.

Alternatively if the company is to be wound up, a winding up notice must be lodged with the ASIC and the VA winds up the company as if it were a creditors' voluntary liquidation.

The time constraints on a VA are onerous given the tasks required. The main concern is to maximise recovery to creditors, and usually the best way to do this is preserve the business. To overcome time constraints, pre-appointment planning and access to experienced staff are vital.

The VA's independence is of paramount importance. Creditors must have confidence in the independent voice.

A VA's responsibilities

The VA's key responsibilities are to assess the viability of the business, to maintain it as a going concern if at all possible. If this is not possible, to enable creditors to receive a result that is better than would be achieved from the immediate winding up of the company. The VA is required to report to creditors advising them of his/her opinion as to the alternatives available and as to the appropriate course of action. To do this he/she must investigate the reasons for insolvency and also when the company became insolvent. This is particularly relevant where the company's proposal involves trading on and contributing to creditors from future generated profits. Were a Liquidator to be appointed, the Liquidator is able to claim back certain transactions and to take recovery action against Directors guilty of breaching the *Corporations Act*. Thus the VA is required to identify and comment on the occurrence of these matters and to report to creditors on the likelihood of recovery being made by a Liquidator. Were the creditors to accept a proposal from the Directors, they in essence forsake their ability to have the various recovery actions instituted by a Liquidator, and as an alternative, accept a commercial compromise.

Our experience is that Voluntary Administrations are a large improvement on what we previously had. We now have a process whereby all Creditors, (should they so choose) whether they are secured, unsecured or employees and the directors can work together in a co-operative fashion to resolve their difficulties in a commercial manner to maximise their return and maintain business relationships.

Frequently Asked Questions

Administrators

Q: ***What <u>PERSONAL LIABILITY</u> do Voluntary Administrators have?***

A: Their personal liability is governed by section 443A of the *Corporations Act* in respect of debts incurred - in performing the role of Administrator - for services rendered, goods purchased and property hired, leased, used or occupied.

Q: ***Where does a Voluntary Administrator stand in terms of PRIORITY FOR DEBTS INCURRED?***

A: Administrators have first ranking liens over assets of companies in respect of the Administrator's fees and costs incurred. The liens discontinue if, for example, a secured creditor chooses to appoint a Receiver.

Q: ***What gives an Administrator a LIEN OVER ASSETS?***

A: By statute an Administrator is given a lien pursuant to section 436 of the Corporations Act.

Q: ***What happens if a company is NOT INSOLVENT BUT APPEARS TO BE IN DANGER of becoming so?***

A: A Voluntary Administration is available as an option. The section of the Corporations Act that provides for such an appointment is Section 436A , which states:- "is.... or is likely to become insolvent at some future time ...".

Example

A company is embroiled in litigation and it is uncertain that the company will successfully defend the action. In the event of the loss of that action, the company's own legal costs and the successful party's claim inclusive of their legal costs, could result in the company's insolvency.

Directors

Q: ***How does the DEFINITION OF A DIRECTOR as described in the Corporations Act Section 60 compare with the definition in the Income Tax Assessment Act?***

A: Section 60 defines a director as:-

(a) a person occupying or acting in the position of Director of the body, by whatever name called and whether or not validly appointed to occupy, or duly authorised to act in, the position;

(b) a person in accordance with whose directions or instructions the Directors of the body are accustomed to act;

(c) in the case of a body incorporated or formed outside Australia:

   (i) a member of the body's board;

   (ii) a person occupying or acting in the position of member of the body's board, by whatever name called and whether or not validly appointed to occupy, or duly authorised to act in, the position; and

(iii) a person in accordance with whose directions or instructions the members of the body's board are accustomed to act.

This definition is very similar to the definition of a director in the *Income Tax Assessment Act* in section 160APA. By virtue of section 160APA "director" includes any person occupying or acting in the position of Director of a company, by whatever name called and whether validly appointed to occupy, or duly authorised to act in, the position. Also section 8Y of the Taxation Administration Act states that persons concerned in, or who take part in, the management of a corporation will be liable for prosecution for offences committed by the company against taxation laws as if they had committed those offences themselves.

Q: IF YOU NEED TO MAKE A FORMAL APPOINTMENT WHAT IS THE QUICKER TYPE OF APPOINTMENT BETWEEN A PROVISIONAL LIQUIDATION OR A VOLUNTARY ADMINISTRATION

A: A Voluntary Administration can be initiated simply by a Director's meeting resolving those matters set out in the *Corporations Act* followed by the signing of a document. This is to be compared to the appointment of a Provisional Liquidator which requires as its pre-requisites a Director's meeting, a shareholders meeting, the instruction of a lawyer, the making of a formal application to the Court and waiting for a time for the Court to hear the matter. Even when the Court hears the matter, it has discretion to either grant the order or refuse it. Furthermore, if the Directors and the shareholders of the company differ then there could be difficulty in getting the shareholders to approve of the appointment of the Provisional Liquidator.

Q: IS THE SPEED OF A VA RELEVANT?

A: Yes. It is very important regarding Director's liability under the insolvent trading provisions of the Corporations Act and under section 222 of the Income Tax Assessment Act. For instance, under a Voluntary Administration the directors immediately cease to be liable for a claim to insolvent trading and for tax where the appointment is made within 14 days of the issuing of a notice under the Income Tax Assessment Act.

On the other hand, whilst the Directors are waiting to get a Court appointed Provisional Liquidator their liability continues for insolvent trading and they become liable for tax where they do not get the appointment within 14 days of the issuing of the notice under the *Income Tax Assessment Act*.

Q: What is the EFFECT ON PERSONAL GUARANTEES SIGNED BY DIRECTORS on the appointment of a Voluntary Administrator?

A: Section 440J provides that during the administration of a company:-

(a) a guarantee of a liability of the company cannot be enforced, as against:-

(i) a Director of the company who is a natural person; or

(ii) a spouse, de facto spouse or relative of such a Director; and

(b) without limiting (a) a proceeding in relation to such guarantee cannot be begun against such director, spouse de facto spouse or relative; except with the leave of the Court in accordance with such terms (if any) as the Court imposes.

Q: What is the EFFECT ON PERSONAL GUARANTEES SIGNED BY DIRECTORS on the execution of a DOCA?

A: This is a difficult question to answer as it encroaches on an area where the law is evolving. It appears to depend on a number of things :-

(a) Whether or not the guaranteed creditor attended at the meeting and voted in favour of the DOCA;
(b) What the guarantee document actually contains in its provisions;
(c) What the Court interprets the intent, purpose or provisions of the Corporations Act to be regarding the enforcement of guarantees in such a case.

It is our view that personal guarantees are not extinguished simply by virtue of the DOCA. If guarantees are to be effectively extinguished, such an agreement should be signed individually by all guarantee creditors.

Q: WHERE THERE ARE BREACHES OF THE CORPORATIONS ACT BY DIRECTORS, is an Administrator obligated to report matters to any relevant authority?

A: Yes. Pursuant to section 438D an Administrator is required to report offences to ASIC where it appears that officers may have committed offences. It may be that even if the company's creditors accept a DOCA that the relevant authorities could still subsequently undertake action against directors. The *Corporations Act* prohibits a wide range of conduct that can be reported on. For example:-

1. *Management* - misconduct in relation to running a company.
2. *Disclosure* - failure to disclose significant company information, including the reporting of financial statements.
3. *Insolvent trading* - companies trading while insolvent.
4. *Fundraising* - misconduct in relation to prospectus requirements and related fundraising.
5. *Takeovers* - unacceptable share acquisitions.
6. *Markets* - unlawful trading in securities and futures markets.
7. *Investment through brokers and advisers* - misconduct of securities and futures dealers and investment advisers.

Q: In a case where there is a SUDDEN PROPERTY SLUMP reducing the value of the assets of the company thereby rendering the company insolvent on a assets v liability basis. What is Macks Advisory's VIEW ON DIRECTORS WHO BREACH INSOLVENT TRADING LAWS IN THESE CIRCUMSTANCES ... whereas perhaps only a few days earlier there would not have been a breach?

A: Courts have determined that in respect of debts being incurred it is the time they are incurred (pursuant to section 588G of the Law) which is critical. Irrespective of whether assets may have increased or decreased substantially in value, it is their value at the time debts against them were incurred, which matters. A case would depend on individual facts, and the law has made it clear that whether a company is actually solvent, can depend on more than its balance sheet. Directors may be saved from the consequences of insolvent trading under section 588G where, for example, a secured creditor agrees to honour debts being incurred.

Q: DIRECTORS DON'T HAVE ANY POWERS to decide things ONCE A VOLUNTARY ADMINISTRATOR IS APPOINTED. What does a Voluntary Administrator say to them?

A: A Voluntary Administrator should get the Directors on side by involving them in decision making on the basis that the aim is to resuscitate the company for the benefit of the company and its creditors. Macks Advisory endeavours to get directors to rationalise decisions that need to be made by an Administrator so they become party to, and agree with, such decisions.

Q: ***Is there anything to stop DIRECTORS from BUYING ASSETS subsequently disposed of at auction, and using those assets to establish another business.***

A: No. Commercially there isn't. However Liquidators may submit adverse reports on Directors to the Australian Securities & Investments Commission, which under Section 600 of the *Corporations Act*, may take action to ban such Directors from acting as Directors of other companies.

Q: ***What is meant by the requirement of A MAJORITY OF DIRECTORS to decide to make an appointment? Is it a majority of the Directors attending a meeting, which discusses this, or is it a majority of all a company's Directors?***

A: Section 436A of the *Corporations Act* states a company may, by writing under its common seal, appoint an administrator of the company, if the board has resolved to the effect that:-

(a) in the opinion of the Directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time; and
(b) an Administrator of the company should be appointed.

The memorandum and articles of association of a company will specify the requisite number of Directors needed to commit it, at a Directors' meeting, to a course of action.

Q: ***What is the position in respect to DIRECTORS BEING ENTITLED TO AND EXERCISING VOTING RIGHTS ON THE BASIS OF DIRECTORS' LOAN ACCOUNTS?***

A: Directors' loan accounts are obviously a sensitive issue for many creditors. However, directors do have a right to vote if their loan accounts are legitimate. It is the role of a meeting's chairman to adjudicate on the value and entitlement to vote in respect of Directors' loans, and before the meeting an Administrator should obtain documentation on the Directors' loan account and determine the Administrator's position in respect of it.

Q: ***Does Macks Advisory approve of DIRECTORS BEING PAID during a trading administration?***

A: It is very important that there is, in essence, a co-operative relationship between the Directors and the Administrator. Directors know the workings of their company and all will generally co-operate. This is one of the advantages of the voluntary administration regime. Most companies Macks Advisory deal with are "mum and dad companies" who have gone through tough times. It is important to keep these people on side and to be able to use their constructive thoughts. Therefore, if Directors are working and contributing to the company's business, they should be paid.

Q: ***What is the effect on a business which has been in voluntary administration, IF ITS DIRECTORS REPURCHASE ASSETS OF THE COMPANY?***

A: In our experience the Directors may need to earn the respect of creditors again, and need to trade on a cash basis for a short time. Most creditors are used to having a certain percentage of bad debts and therefore are prepared to give Directors who have called for a Voluntary Administration a second chance - especially when the Directors have shown a sense of responsibility by taking early action to prevent the financial position of their company deteriorating further.

Q: ***What are DIRECTORS' RESPONSIBILITIES during a voluntary administration?***

A: Whilst Directors' powers are suspended under section 437C of the *Corporations Act*, they must assist and co-operate with the Voluntary Administrator.

Q: ***What is the QUALITY OF FINANCIAL INFORMATION provided to Administrators by directors?***

A: In Macks Advisory's experience, the quality of financial information provided to the Voluntary Administrator is usually of a higher standard than provided in liquidation. A reason for this is that before a Voluntary Administrator is appointed, the Administrator is able to review the company's financial position and assist the Directors with the information required. Since the Directors have already taken the initiative by voluntarily calling on Macks Advisory for help, they are going to act with probity to ensure the position of their company does not worsen - which could happen if they failed to give Macks Advisory anything less than top quality financial information.

Q: ***It's been said it's important at a second meeting of creditors to have OPEN AND FRANK DISCUSSION. Does this allow for shouting and yelling?***

A: No. The Voluntary Administrator has a duty to ensure the meetings are conducted in an orderly and proper manner. Furthermore, it is very important for Directors to put their cards on the table in an atmosphere that is conducive to that happening. For example, in many cases there may have been insolvent trading by Directors, which could put at risk their personal assets. Because it may be costly for an Administrator to prove certain Directors do not have any personal assets (for example significant mortgages may be registered over the houses they own) it saves costs in running an administration - which benefits creditors - when Directors are immediately frank and honest about their personal finances. Should creditors discover from other sources that Directors' finances are not as they've been represented - for example that they have substantial personal assets they haven't declared - then this could give rise to antagonism, the end result of which would disrupt and greatly devalue an administration.

Q: ***What happens if a COMPANY IN VOLUNTARY ADMINISTRATION CONTINUES TO TRADE AT A LOSS?***

A: Administrators are personally liable in this situation and will make decisions accordingly. They will usually continue to operate a business, but scaled down. They understand that generally the realisation of the assets of a business is greater when the business is seen to be a going concern.

Benefits of a Voluntary Administration

Q: ***What is the benefit of a Voluntary Administration - IS IT REALLY A COST ADVANTAGE?***

A: The Voluntary Administration regime now enables a mechanism for staying creditors' actions and winding up proceedings whilst reconstruction and rehabilitation strategies are implemented. Certainly cost is an issue. A Voluntary Administrator does not have to deal with many matters imposed upon a liquidator and this, as a consequence, reflects favourably on costs. But the flexibility of Voluntary Administration is its main virtue, offering as it may, opportunities for companies to survive long term for the benefit of directors and creditors. Similarly, if it's apparent a company can't survive long term, then the flexibility available in Voluntary Administration would mean the company's assets could be handled in such a way as to achieve the best possible financial result for both it and its creditors. Regulatory requirements of liquidators generally prove to be costly for companies one way or another.

Q: ***What is the MARKET REACTION to a company going into voluntary administration?***

A: Most creditors are supportive of the voluntary administration process. If proposals from Directors of companies are apparently achievable, administration is regarded by creditors as a better option than liquidation because they are likely not only to receive higher dividends, but have retained an on-going customer.

Q: ***Do Administrators have to RECOVER PREFERENCES?***

A: It is not the role of an Administrator to pursue preference payments. The Administrator's role is to investigate the books and records of the company under administration to, among other things, identify, analyse and highlight possible preference payments made to creditors. This is so creditors can decide whether it will be in their best interests to accept a proposal from a particular company and enter into a Deed of Company Arrangement, or to resolve that the company go into liquidation. If liquidation is the chosen option, then the Liquidator will pursue preference payments.

Q: ***What happens with a company AFTER THE VOLUNTARY ADMINISTRATION PROCESS IS COMPLETED. Can it carry on business?***

A: Control is returned to Directors after creditors at their second meeting have accepted the Voluntary Administration proposal and the DOCA has been executed. What happens is then up to the Directors. They have full control of the company's assets and can carry on the business if they so desire subject to the terms of the DOCA.

Administration

Q: ***Can a PROVISIONAL LIQUIDATOR become a VOLUNTARY ADMINISTRATOR?***

A: Yes. Consider a case where two Directors are arguing about a certain course of action and as a consequence, one of the Directors (because of the Directors' inability to have a Voluntary Administrator appointed) appoints a Provisional Liquidator. Subsequently, the other Director recognises the wisdom of the other Director and both Directors then decide a proposal should be put to the company's creditors. The provisional liquidator can approach the court and ask to be appointed as Voluntary Administrator.

Q: ***WHAT CENTS IN THE DOLLAR ARE BEING PAID to creditors in Voluntary Administrations?***

A: There has been a wide range in Macks Advisory's experience - from five cents to 100 cents in the dollar. An example of the five-cents-in-the-dollar dividend might be where significant monies were paid to preferred creditors such as employees and a Director forgave her loan account which accounted for about 50% of total creditors' claims. The Director, while forgiving her claim, only increased the distribution of funds marginally, but the gesture had a profound psychological effect in persuading creditors to accept the DOCA. An example of the 100-cents-in-the-dollar dividend might be when a holding company paid in monies because it wanted to maintain goodwill with suppliers. The important consideration, however, is the comparison of what creditors would receive in an administration compared to a liquidation.

Q: ***If there is a LARGE RETAIL ADMINISTRATION how would Macks Advisory deal with that?***

A: It is very important to visit all stores in the early days of an administration, talk to employees, tell them what is happening and discuss with them a plan. You must be frank with employees - usually a business's most valuable resource - if you are to gain their confidence. Macks Advisory would also coordinate stock-takes and valuations.

Q: ***What happens IF BOOKS AND RECORDS OF A COMPANY seeking Voluntary Administration are in poor order?***

A: This can be a major problem for an Administrator where a significant amount of work needs to be done before an appointment is made. There is a legal time frame in which an Administrator must operate after the appointment. For example, such basic things as a list of creditors by name and address is essential so that they can be notified of the appointment and invited to attend an initial meeting within 8 business days of the appointment.

Q: ***What happens about BANK ACCOUNTS?***

A: All bank accounts of a company in Voluntary Administration are frozen. Where there are no funds to pay off overdrafts, interest will continue to accrue. An Administrator would open a new bank account in the name of the company under administration, but would include in the title of the account "Administrator Appointed". The Administrator would then deposit all monies received into this new bank account.

Q: ***What vote is required TO MAKE SURE A DEED OF COMPANY ARRANGEMENT GOES AHEAD?***

A: Assuming a poll is called it is a simple majority in number and value of creditors at a meeting to resolve that they will accept the deed proposed by Directors. If there is a situation where more than 50% in value want the deed to go ahead but 50% in number don't, or vice a versa, then the chairman has a casting vote.

Q: ***WHO SIGNS THE DEED OF COMPANY ARRANGEMENT?***

A: All persons who are parties to the DOCA must sign it. For example, at the very minimum, the Directors would sign the DOCA. The company must sign the DOCA and for this limited purpose the Directors are empowered to use the company's common seal. An Administrator is a signatory and if someone has forgiven either his or her loan, then that party must sign the DOCA.

Q: ***WHO CAN CHAIR A PROPOSAL MEETING?***

A: The rules for convening, conducting, and voting at creditors meetings in corporate insolvencies are laid down by the *Corporations Act* and regulations. The regulations governing the convening, conduct of and voting at a meeting of creditors convened under Part 5.3A (VA) apply in common with liquidation.

Nomination of another person to chair.

The regulations state that if a meeting is convened by the Administrator, then the Administrator, or a person nominated by the Administrator, must chair the meeting.

Similarly, the regulations state that a Voluntary Administrator (or the Administrator of a Deed of Company Arrangement) who convenes a meeting of creditors must chair, or must nominate the person to chair that meeting.

The *Corporations Act* itself requires that at the proposal meeting "the administrator is to preside" (sec.439B, see also 439A). No such prescription is laid down for the first meeting of creditors in VA.

Q: What is the LIABILITY OF A HOLDING COMPANY FOR INSOLVENT TRADING BY A SUBSIDIARY?

A: If the holding company has a subsidiary which incurred a debt, and the holding company knew or should have known that the subsidiary was insolvent, a liquidator may take action against the holding company.

Q: What is the process for EXTENSION OF TIME for meetings?

A: There is no extension for holding a first meeting. There is the possibility of extending the convening period for a second meeting, but the Voluntary Administrator must go to Court to obtain that. However, when the second meeting is held it can be adjourned, but for no more than 45 business days.

Q: What is the position with CONTRACTS?

A: If a contract has been entered into before a company goes into administration then usually that contract is enforceable save and except where the contract contains an express provision that it terminates or can be terminated consequent upon the appointment of an Administrator. The Administrator is an agent of the company and therefore the contract is not severed or terminated by virtue of the appointment of the Administrator. For example, Macks Advisory was involved in the administration of a restaurant in which a contract for the sale of the business had been signed before the appointment of the Administrator, but not settled. Macks Advisory's solicitors' advice was that the Administrator was bound by the contract.

Q: How short is the PERIOD OF A VOLUNTARY ADMINISTRATION?

A: It's relatively short compared with provisional liquidation and liquidation. The first meeting of creditors must be within 8 business days after the administration begins, pursuant to section 436E(2) of the *Corporations Act*. A second meeting must be held <u>within 5 business days before or after the end of the convening period</u>. This second meeting is the all-important meeting at which the creditors decide the fate of the company. The convening period is subject to one exception, when an appointment occurs in December, and may take 25 business days from the first day of an administration but otherwise must be convened within 20 business days. However, Administrators can go to Court and ask for extensions of convening periods, which will be granted provided there are valid reasons - for example, the need to unravel the inter-relationships of a complex group of companies; more information is needed for a possible sale of a business; a report is required on the financial affairs of Directors. But most administrations are conducted along standard lines.

Q: Do Administrators have problems with RETENTION OF TITLE?

A: There are various ways retention-of-title issues may arise in insolvencies. However, pursuant to section 442C of the Corporation Laws, goods subject to retention of title claims can be disposed of by Administrators in the ordinary course of business. This means that administrations cannot be stalled by these issues. This is another advantage of a Voluntary Administration over a Provisional Liquidation. However, Macks Advisory usually ask suppliers to provide all documentation relating to such matters and Macks Advisory then allows them to undertake a stocktake. If Macks Advisory assesses a retention of title claim as valid, then Macks Advisory will allow for it in the on-going business. If there is some doubt about a retention of title clause, then depending on the nature of Macks Advisory's concerns, Macks Advisory may enter into a commercial arrangement to save costs (eg. legal costs in resolving disputed claims) or may totally reject claims.

Q: What is the SHORT TERM EFFECT OF A VOLUNTARY ADMINISTRATION ON A COMPANY'S EMPLOYEES, especially on their morale?

A: In Macks Advisory's experience, few staff quit. Macks Advisory will always fully inform employees on day one of an administration, explaining procedures to them, just as is done with Directors. Macks Advisory tells workers that they depend on Directors' cooperation and are acting on behalf of creditors - and of course employees are creditors in their own right for such things as annual leave and long service leave. Macks Advisory encourage employees to discuss issues and to be involved with a committee of creditors; and they have consistently been very supportive. Obviously it is in employees' interests as well as Directors' for administrations to continue, because not only will their entitlements have a greater chance of being met, but their jobs will be maintained. But Macks Advisory stress' employees should always be kept informed by Administrators. One of the legislative objectives in creating the voluntary administration regime was to retain employment of the company's employees which was not adequately catered for by other types of insolvency administrations.

Q: What is the POSITION WITH SUBCONTRACTORS?

A: Subcontractors can be vital to a business's survival. For any work done after our appointment Macks Advisory ensures that they are paid promptly, sometimes even ahead of schedule, so that their goodwill is assured. However, in respect to money owed to subcontractors previous to our appointment, Macks Advisory make commercial decisions based on what is best for individual businesses.

Q: How long is the VOLUNTARY ADMINISTRATION PRE-APPOINTMENT PERIOD?

A: The pre-appointment period is very important in Voluntary Administrations because unlike liquidations or receiverships where insolvency practitioners usually know little about companies at the times of their appointments, in Voluntary Administrations they initially meet with companies' accountants, solicitors and directors to explain the process. In this way the people involved get to know each other and can fully understand the opportunities and problems presented by the situation. In this time it is also important for Administrators to be able to put in place systems so that from the start of their Administrations it is business as usual - which will include drafting letters to employees, customers and creditors, reviewing ordering procedures and wage systems, and maintaining lease payments. Meanwhile Administrators can use this time to understand as much as they can about the businesses they have to administer. Pre-appointment periods are not very long and vary according to the nature and complexity of the company to be placed in Administration.

Q: Can RELATED PARTIES VOTE at administration meetings?

A: Yes, but Macks Advisory ensure that their debts have been carefully scrutinised and reviewed, especially before the second meeting, which is the one that in effect decides the fate of the company. Should a related party's vote appear likely to affect the decision then Macks Advisory would advise creditors of this. There is also protection for creditors pursuant to section 600A of the *Corporations Act*. In essence this section states that if at a meeting of creditors a resolution is passed because of a related party's vote and if the decision is contrary to the interests of all creditors, then a Court may set aside the resolution.

Q: Is the SALE OF ASSETS of a business an option with a Voluntary Administration?

A: Yes. It depends on the circumstances in each case. Macks Advisory understands that under Part 5.3A of the *Corporations Act* - which is the part that deals with Voluntary Administrations - it is not obligatory to advertise a business's assets for sale, because the aim of an Administration is to produce a better result than liquidation.

Q: Does the Voluntary Administration process apply to A COMPANY WHICH ACTS AS A TRUSTEE?

A: Yes. As Voluntary Administrator of a company which is trustee for a trust, the Administrator is able to control the trust's assets. A general proposition of law is that a trustee of a trust has a right of indemnity against the trust assets.

Q: How intense is the TRADING ASPECT of the VOLUNTARY ADMINISTRATION PROCESS?

A: There is a lot of intensity in the first few days to set up systems for such things as banking, ordering supplies and for talking to employees, but after that, trading usually settles down. It is in the interests of Directors to do the right thing and co-operate, so trust between them and an Administrator naturally grows quickly. Provided systems and controls are quickly in place, then proper monitoring of a business can be achieved. Macks Advisory always has a significant presence on premises in the first few days. However this is soon reduced, although we usually have regular meetings to review trading results and any other matters or issues.

Q: What is the DIFFERENCE BETWEEN RECEIVERSHIP AND VOLUNTARY ADMINISTRATION?

A: A receiver has a specific and primary duty to the appointor, the secured creditor - although there is a general duty to all creditors so as to maximise returns from sales of assets. <u>An Administrator acts for all the creditors</u>. Another significant difference is that while a Receiver and Manager must immediately take steps to realise assets on behalf of a secured creditor, a Voluntary Administrator does not <u>have</u> to sell assets. An Administrator has flexibility under the *Corporations Act* to act on behalf of <u>all creditors</u> and in their best interests. Accordingly, many proposals by Directors in Voluntary Administrations involve companies needing breathing spaces in order to pay a percentage of long standing creditors from funds to be generated in the future - such companies restarting with clean balance sheets and stronger structures. As a variation of this approach, under-performing assets may be realised by Administrators in orderly sales so as to pay long-standing creditors.

Q: ***Can Voluntary Administrations be used for PARTNERSHIPS?***

A: No. A partnership is not a corporate entity and Voluntary Administrations relate only to companies under the *Corporations Act*. However the Voluntary Administration process is very similar to the Part X principle of Bankruptcy Act 1966, whereby individuals can come to arrangements with creditors so as to avoid bankruptcy. A similar arrangement philosophy governs the Voluntary Administration process.

Banks

Q: ***What is happening with BANKS? ARE THEY ACCEPTING VOLUNTARY ADMINISTRATIONS OR ARE THEY NOT?***

A: Banks have a window of opportunity within 10 business days to appoint a Receiver under their securities. Alternatively they can appoint one subsequently with an Administrator's agreement or by order of a court. In any case, banks are informed before an appointment so that they are able to make commercial decisions in relation to how their securities will be handled. Often banks have collateral securities, which they can rely upon, and their security over assets of a company may be of little or no value.

Q: ***What is the DEFAULT CLAUSE enabling a bank to appoint an Administrator? Is it insolvency?***

A: The ability of a bank to appoint a Receiver reflects the requirements of its mortgage debenture document. The *Corporations Act* enables banks to appoint by notice (pursuant to section 436C). The requirements of mortgage debenture documents vary greatly - for example a document may allow a bank to appoint on, say, advice from Directors that their company is insolvent. It may be there is a clause enabling a bank to appoint a Receiver if it suspects a company is insolvent, or is concerned that the assets which are the subject of its security, are at risk.

Q: ***What is the ATTITUDE OF BANKS TO VOLUNTARY ADMINISTRATIONS?***

A: Most banks are prepared to accept the process with the proviso that Administrators fully discuss the path they expect to follow. It is very important to all creditors, and obviously to banks, to be fully informed by Administrators.

Creditors

Q: ***Can Voluntary Administrators pay CREDITORS OF THE SAME CLASS DIFFERENT AMOUNTS?***

A: Yes. In the case of <u>Lamsoon Australia v Molit (No. 55) Pty. Ltd.</u> the Court has ratified a Deed of Company Arrangement which provided for different treatment of <u>CREDITORS IN THE SAME CLASS</u>. The effect of the Court's judgment was that a Voluntary Administration was an effective tool for discriminating between same-class creditors on the basis of a reasoned commercial assessment of benefit to <u>all</u> creditors.

The DOCA divided creditors into:

(a) non-associated creditors as at the date of Macks Advisory's appointment

(b) future non-associated creditors as at this date

(c) associated creditors.

All involved in this administration, with the exception of the landlord, accepted the distinction as part of the DOCA, and also that those in class (i) would be paid in full (by a holding company) that class (ii) should receive a dividend calculated as a result of dividing by the total claims of all three classes, the total assets of the holding company, less costs of the Administration. Class (iii), it was agreed, should not be paid either in whole or in part during the term of the DOCA. The landlord wouldn't abide by the DOCA, took the matter to court, and eventually lost, the Full Court ruling that he was bound by the DOCA, it being a properly devised separation of creditors <u>within the same class.</u>

Q: With Voluntary Administrators making OFFERS TO CREDITORS FOR PERCENTAGES OF PROFITS FOR TRADING, what is the incentive for creditors to accept such proposals?

A: The incentive is that perhaps there is little money available from the immediate liquidation of a company. Also the creditors get some benefit from on-going trading with the company, arguably, for example, profits from sales, and market share.

Q: Are DRAFT DEEDS presented to meetings of creditors?

A: There is no legal requirement for presentation of a draft of a DOCA to a meeting. However, it is considered to be prudent for a Voluntary Administrator to fully inform creditors of proposals. In any case, copies of the Directors' proposal, which is usually a simplified letter dealing with terms of the offer, are sent to all creditors.

Q: What are the advantages of ADMINISTRATION over immediate Liquidation?

A: The creditors are included in the process and within a month after the appointment of an Administrator, there are two meetings with creditors. Creditors want to know what is happening, whereas previously in court liquidations, a creditors' meeting might not be held until months after the appointment of a liquidator. In the Voluntary Administration process creditors are included, and included early.

Q: What are the expectations of creditors at the FIRST MEETING OF CREDITORS?

A: Obviously creditors are concerned by the financial position of a company in Voluntary Administration and they are quite rightly wanting to know what has happened. However, the purpose of the first meeting is to deal with two matters, one being whether creditors want to form a committee and the other whether they want to change the Administrator. Inevitably Administrators have only been involved with companies for short periods and knowledge of the companies is limited.

However, they try to understand as much about company matters as possible before the required first meeting so as to be able to give creditors information. Specific questions from creditors are usually taken on notice, so that issues involved can be thoroughly researched and answers provided promptly.

Q: WHO DO VOLUNTARY ADMINISTRATORS REPRESENT in an administration?

A: Whilst an Administrator may have been appointed by the Directors of a company, the Administrator represents the interests of the creditors of the company. An Administrator, having been appointed, is independent of the Directors. Macks Advisory takes the view that this must be emphasised and brought to the attention of the Directors before the appointment, so that there are no misunderstandings.

Q: What information is required to be given to a SECOND MEETING OF CREDITORS?

A: The *Corporations Act* states that in calling the second meeting of creditors, the Administrator must provide a report on the company's business, property, affairs and financial circumstances. They must also include a statement setting out the Administrator's opinion on what is in the creditors' interests and the reason for that opinion.

Q: Will CURRENT PROFIT MARGINS be available to creditors?

A: That depends on Directors' proposals. If directors propose that payment to creditors should be made from future trading, then current profit margins will be available to creditors. However if directors propose to sell assets or obtain monies from third parties, or sell their houses to put money into a company in administration, then profit margins current at that time, would not subsequently be available to creditors.

Q: What sort of NOTICE is an Administrator supposed to give creditors?

A: an Administrator is required to provide 5 business days' notice of a meeting of creditors. As noted previously, Administrators are also required to advertise their appointment and the meeting of creditors in the public notices of a newspaper in the State/s in which the business operates.

The Administrator will write to all creditors he is aware of from information from the directors, the records of the company, or where creditors have advised of a claim.

Suppliers

Q: What happens if a MAJOR SUPPLIER, before a Voluntary Administrator is appointed chats to a Director (who knows about the impending appointment) and ARRANGES WITH THE DIRECTOR TO BE PAID a substantial amount of money to virtually wipe out a potential claims- the deal not being disclosed to other creditors? Can such commercial or strategic deals be done?

A: Such deals are inconsistent with the spirit of the legislation, which requires full and frank disclosure of information to all creditors so that they can jointly make appropriate decisions. Where such an arrangement is disclosed to other creditors, then it may be that they should seek to appoint a Liquidator, and to recover the money. Where the creditors subsequently become aware of this supplier's preferential treatment, they, or the Voluntary Administrator could apply to the court to overturn a DOCA because there was a material fact not disclosed to creditors, or where there was public interest, then the Australian Securities & Investments Commission (ASIC) could also intervene under Section 600A of the *Corporations Act*.

Q: ***What is the ATTITUDE OF SUPPLIERS to the appointment of a Voluntary Administrator?***

Macks Advisory has a good relationship with many of those suppliers who find themselves creditors, because we've previously dealt with them. Suppliers also take some comfort in knowing that Administrators have a legal liability in that they are personally responsible for any expenses they incur. A further consideration is that suppliers normally would make their gross margins in their trading terms, so there would be a benefit for them in continuing to trade with Administrators. Suppliers, by their co-operation with the Administrator, seek to help create situations where the DOCA can be concluded without delay and trading can go ahead, if that's at all possible.

Q: ***What should a VOLUNTARY ADMINISTRATOR'S relationship be WITH A MAJOR SUPPLIER?***

A: On day one of an administration, major suppliers should be visited and told the reasons for the appointment. By being frank and honest with suppliers and asking for their continued support, Macks Advisory has received excellent responses most of the time.

INFORMATION SHEET 42

Insolvency: a guide for directors

This information sheet provides general information on insolvency for directors whose companies are in financial difficulty, or are insolvent, and includes information on the most common forms of external administration.

An insolvent company is one that is unable to pay all its debts when they fall due for payment. There are serious penalties for allowing your company to trade while insolvent. If your company is in financial difficulty, you should seek independent advice on your duties and the options available.

Who is a director?

A director is not just a person appointed to that role. Under the *Corporations Act 2001* (Corporations Act), a person may also be a director if they are not formally appointed but act in that role, or if the directors of the company act in accordance with their instructions or wishes.

Directors' duties

Generally, in addition to the requirement to ensure compliance with general and specific laws applying to your company's operations, your primary duty is to the shareholders. However, if your company is insolvent, or there is a real risk of insolvency, your duties expand to include creditors (including employees with outstanding entitlements).

General duties

General duties imposed by the Corporations Act on directors and officers of companies include:

- the duty to exercise your powers and duties with the care and diligence that a reasonable person would have, which includes taking steps to ensure you are properly informed about the financial position of the company and ensuring the company doesn't trade if it is insolvent
- the duty to exercise your powers and duties in good faith in the best interests of the company and for a proper purpose
- the duty not to improperly use your position to gain an advantage for yourself or someone else, or to cause detriment to the company, and
- the duty not to improperly use information obtained through your position to gain an advantage for yourself or someone else, or to cause detriment to the company.

Important note: This information sheet contains a summary of basic information on the topic. It is not a substitute for legal advice. Some provisions of the law referred to may have important exceptions or qualifications. This document may not contain all of the information about the law or the exceptions and qualifications that are relevant to your circumstances. You will need a qualified professional adviser to take into account your particular circumstances and to tell you how the law applies to you.

Duty to not trade while insolvent

As well as general directors' duties, you also have a positive duty to prevent your company trading if it is insolvent. A company is insolvent if it is unable to pay all its debts when they are due. This means that before you incur a new debt you must consider whether you have reasonable grounds to suspect that the company is insolvent or will become insolvent as a result of incurring the debt.

An understanding of the financial position of your company only when you sign off on the yearly financial statements is insufficient. You need to be constantly aware of your company's financial position.

Duty to keep books and records

Your company must keep adequate financial records to correctly record and explain transactions and the company's financial position and performance. A failure of a director to take all reasonable steps to ensure a company fulfils this requirement contravenes the Corporations Act.

For the purposes of an insolvent trading action against a director, a company will generally be presumed to have been insolvent throughout a period where it can be shown to have failed to keep adequate financial records.

Consequences of insolvent trading

There are various penalties and consequences of insolvent trading, including civil penalties, compensation proceedings and criminal charges.

The Corporations Act provides some statutory defences for directors. However, directors may find it difficult to rely upon these if they have not taken steps to keep themselves informed about the company's financial position.

Civil penalties

Contravening the insolvent trading provisions of the Corporations Act can result in civil penalties against directors, including pecuniary penalties of up to $200,000.

Compensation proceedings

Compensation proceedings for amounts lost by creditors can be initiated by ASIC, a liquidator or a creditor against a director personally. A compensation order can be made in addition to civil penalties.

Compensation payments are potentially unlimited and could lead to the personal bankruptcy of directors. The personal bankruptcy of a director disqualifies that director from continuing as a director or managing a company.

Criminal charges

If dishonesty is found to be a factor in insolvent trading, a director may also be subject to criminal charges (which can lead to a fine of up to $220,000 or imprisonment for up to 5 years, or both). Being found guilty of the criminal offence of insolvent trading will also lead to a director's disqualification.

ASIC has successfully prosecuted directors for allowing companies to incur debts when the company is insolvent, and has sought orders making directors personally liable for company debts. ASIC also runs a program to visit directors, where appropriate, to make them aware of their responsibilities to prevent insolvent trading.

The good news is that taking steps to ensure your company remains financially sound will minimise the risk of an insolvent trading action. It may also improve your company's performance.

What to do if you suspect financial difficulty

If you suspect your company is in financial difficulty, get proper accounting and legal advice as early as possible, as this increases the likelihood of the company surviving. One of the most common reasons for the inability to save a company in financial distress is that professional advice was sought too late. Do not have a 'head in the sand' attitude, hoping that things will improve—they rarely do. Table 1 lists some of the warning signs of insolvency.

Table 1: Signs that may indicate your company is at risk of insolvency

- ongoing losses
- poor cash flow
- absence of a business plan
- incomplete financial records or disorganised internal accounting procedures
- lack of cash-flow forecasts and other budgets
- increasing debt (liabilities greater than assets)
- problems selling stock or collecting debts
- unrecoverable loans to associated parties
- creditors unpaid outside usual terms
- solicitors' letters, demands, summonses, judgements or warrants issued against your company
- suppliers placing your company on cash-on-delivery (COD) terms
- issuing post-dated cheques or dishonouring cheques
- special arrangements with selected creditors
- payments to creditors of rounded sums that are not reconcilable to specific invoices
- overdraft limit reached or defaults on loan or interest payments
- problems obtaining finance
- change of bank, lender or increased monitoring/involvement by financier
- inability to raise funds from shareholders
- overdue taxes and superannuation liabilities
- board disputes and director resignations, or loss of management personnel
- increased level of complaints or queries raised with suppliers
- an expectation that the 'next' big job/sale/contract will save the company

An insolvency practitioner can conduct a solvency review of your company and outline available options. You need to be aware of your options so that you can make informed decisions about your company's future. Options may include refinancing, restructuring or changing your company's activities, or appointing an external administrator.

The three most common forms of external administration are:

1. voluntary administration (which may lead to a deed of a company arrangement)
2. liquidation, and
3. receivership.

Of these, only the first two are normally options for directors, as a receiver is usually appointed by a secured creditor. (Other forms of external administration are not explained in this information sheet.)

To find an insolvency professional, visit the Insolvency Practitioners Association website at www.ipaa.com.au. This site lists insolvency accountants and lawyers, and you can search for members in your location.

Tax office s222AOE penalty notice

If you receive a s222AOE penalty notice from the Commissioner of Taxation for your company's unpaid tax, you should immediately seek professional advice. Failure to take appropriate steps within 14 days may result in the Commissioner taking recovery action against you personally for an amount equivalent to the unpaid tax.

What to do if your company is insolvent

If your company is insolvent, do not allow it to incur further debt. Unless it is possible to restructure, refinance or obtain equity funding to recapitalise the company, generally your options are to appoint a voluntary administrator or a liquidator.

Voluntary administration

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

If it isn't possible to save the company or its business, 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 instead been placed straight into liquidation.

A mechanism for achieving these aims is a deed of company arrangement.

Putting a company into voluntary administration is a simple and quick process. It can be done by the board of the company resolving that the company is insolvent, or likely to become insolvent, and an administrator should be appointed. The directors also need to obtain the written consent of a registered liquidator to act as voluntary administrator.

Liquidation

The purpose of liquidation of an insolvent company is to have an independent and suitably qualified person (the liquidator) take control of the company so that its affairs can be wound up in an orderly and fair way for the benefit of its creditors.

An insolvency professional will be able to advise you of the steps required to appoint a liquidator. Generally, a director-initiated liquidation involves calling a meeting of members to vote on winding up the company and the appointment of a liquidator.

Receivership

A company most commonly goes into receivership when a receiver is appointed by a secured creditor who holds security over some or all of the company's assets. The receiver's primary role is to collect and sell sufficient of the company's charged assets to repay the debt owed to the secured creditor.

A director who is also a secured creditor should seek advice before appointing a receiver.

Consequences of external administration

As well as the possibility of insolvent trading action, discussed earlier, there are other consequences for directors of a company that goes into external administration. These vary depending on the type of external administration.

Directors' powers

Directors of companies in voluntary administration or liquidation lose control of the company. If a company goes from voluntary administration into a deed of company arrangement, the powers of the directors depend on the deed's terms. When the deed is completed, the directors regain full control unless the deed provides for the company to go into liquidation on completion.

In a receivership, the powers of the directors depend on the powers of the receiver, as detailed in the charge document, and the extent of the assets over which the receiver is appointed. If the receiver is appointed over all or most of the assets of a company, the receiver effectively has control, although the directors still have certain responsibilities and duties, and may retain residual control.

Directors' obligations

Generally, directors have an obligation to assist the external administrator by:

- advising the external administrator of the location of company property and delivering any such property in their possession to the external administrator
- providing the company's books and records to the external administrator (voluntary administration and liquidation) or giving access to the books and records to the external administrator (receivership)
- advising the external administrator of the whereabouts of other company records
- providing a written report about the company's business, property and financial circumstances within either 5 business days (voluntary administration), 7 days (creditors' voluntary liquidation) or 14 days (receivership and court liquidation) of the appointment of the external administrator, and
- meeting with, or reporting to, the external administrator to help them with their enquiries, as reasonably required.

Directors, officers and other people with relevant books and records have a responsibility to the company and to creditors, and must not obstruct external administrators in carrying out their duties.

Creditors' meetings

Meetings of creditors are held in voluntary administrations and liquidations.

Both a voluntary administrator and liquidator can also require a director to attend a creditors' meeting to provide information about the company and its business, property, affairs and financial circumstances.

Public examination

A voluntary administrator or liquidator has the power to apply to the court to conduct a public examination, under oath, of a director. A receiver can also apply for a public examination, if ASIC consents.

Being summonsed to appear for a public examination is a serious matter and should not be ignored. Seek immediate legal advice if you are in any way concerned about the public examination process or your rights.

The external administrator conducting the public examination may be interested in your personal financial position or further details about assets or transactions the company undertook. Often the need for a public examination can be avoided by cooperating with the external administrator.

Disqualification

If a director has been involved with two or more companies that have gone into liquidation within the last 7 years and paid their creditors less than 50 cents in the dollar, ASIC may disqualify them from managing corporations for up to 5 years. This effectively bans a person from acting as a director.

ASIC can also apply for orders disqualifying a person from managing corporations for up to 20 years if they have been an officer of two or more companies that have failed within the last 7 years, and the way in which the companies were managed contributed to the failures.

Employee entitlement proceedings

It is an offence for anyone, including a director, to enter into an agreement or transaction with the intention of avoiding employee entitlements of a company. The maximum penalty is $110,000 or 10 years imprisonment, or both.

If the company is in liquidation and the employees suffer damage or loss as a result of a person entering into such an agreement or transaction, that person is liable to pay compensation for the loss suffered. This liability can arise even if the person has not been convicted of an offence for the contravention. A recovery action for compensation can be taken by the liquidator or, in certain circumstances, by an employee.

To find out more

For an explanation of terms used in this information sheet, see ASIC information sheet INFO 41 *Insolvency: a glossary of terms*. For more on voluntary administration, liquidation and receivership, see ASIC's related information sheets, available at www.asic.gov.au/insolvencyinfosheets:

- INFO 74 *Voluntary administration: a guide for creditors*
- INFO 75 *Voluntary administration: a guide for employees*
- INFO 45 *Liquidation: a guide for creditors*
- INFO 46 *Liquidation: a guide for employees*
- INFO 54 *Receivership: a guide for creditors*
- INFO 55 *Receivership: a guide for employees*
- INFO 43 *Insolvency: a guide for shareholders*
- INFO 84 *Independence of external administrators: a guide for creditors*
- INFO 85 *Approving fees: a guide for creditors*

These are also available from the Insolvency Practitioners Association (IPA) website at www.ipaa.com.au. The IPA website also contains the IPA's Code of Professional Practice for Insolvency Practitioners, which applies to IPA members.

INFORMATION SHEET 45

Liquidation: a guide for creditors

If a company is in financial difficulty, its shareholders, creditors or the court can put the company into liquidation.

This information sheet provides general information for unsecured creditors of companies in liquidation.

Who is a creditor?

You are a creditor of a company if the company owes you money. Usually, a creditor is owed money because they have provided goods or services, or made loans to the company.

An employee owed money for unpaid wages and other entitlements is a creditor.
A person who may be owed money by the company if a certain event occurs (e.g. if they succeed in a legal claim against the company) is also a creditor, and is sometimes referred to as a 'contingent' creditor.

There are generally two categories of creditor: secured and unsecured.

- A secured creditor is someone who has a security interest (as defined in s12 of the *Personal Property Securities Act 2009*), such as a charge or a mortgage, over some or all of the company's assets, to secure a debt owed by the company. Lenders usually require a security interest over company assets when they provide a loan.
- An unsecured creditor is a creditor who does not have a security interest over the company's assets.

Employees are a special class of unsecured creditors. In a liquidation, some of their outstanding entitlements are paid in priority to the claims of other unsecured creditors. If you are an employee, see ASIC's information sheet INFO 46 *Liquidation: a guide for employees*.

All references in this information sheet to 'creditors' relate to unsecured creditors unless otherwise stated.

The purpose of liquidation

The purpose of liquidation of an insolvent company is to have an independent and suitably qualified person (the liquidator) take control of the company so that its affairs can be wound up in an orderly and fair way for the benefit of all creditors.

Information sheets provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

There are two types of insolvent liquidation:

- creditors' voluntary liquidation, and
- court liquidation.

The most common type is a creditors' voluntary liquidation, which usually begins in one of two ways:

- creditors vote for liquidation following a voluntary administration or a terminated deed of company arrangement, or
- an insolvent company's shareholders resolve to liquidate the company and appoint a liquidator. Within 11 days of being appointed by shareholders, the liquidator must call a meeting of creditors who may confirm the liquidator's appointment or appoint another liquidator of the creditors' choice.

In a court liquidation, a liquidator is appointed by the court to wind up a company, following an application, usually by a creditor. Others, including a director, a shareholder and ASIC, can also make a winding-up application.

After a company goes into liquidation, unsecured creditors can no longer commence or continue legal action against the company, unless the court permits.

It is possible for a company in liquidation to also be in receivership: see ASIC information sheet INFO 54 *Receivership: a guide for creditors*.

The liquidator's role

When a company is being liquidated because it is insolvent, the liquidator has a duty to all the company's creditors. 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, any uncommercial transactions which may be set aside, and any possible claims against the company's officers
- enquire into the failure of the company and possible offences by people involved with 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 under the *Corporations Act 2001* (Corporations Act), a liquidator is not required to do any work unless there are enough assets to pay their costs.

If the company is without sufficient assets, one or more creditors may agree to reimburse a liquidator's costs and expenses of taking action to recover further assets for the benefit of creditors.

In this case, if additional assets are recovered, the liquidator or particular creditor can apply to the court for the creditor to be compensated for the risk involved in funding the liquidator's recovery action.

If a liquidator suspects that people involved with the company may have committed offences and the liquidator reports this to ASIC, the liquidator may also be able to apply to ASIC for funding to carry out a further investigation into the allegations.

Recoveries from creditors

A liquidator has the ability to recover, for the benefit of all creditors, certain payments (known as unfair preferences) made by the company to individual creditors in the six months before the start of the liquidation.

Broadly, a creditor receives an unfair preference if, during the six months prior to liquidation, the company is insolvent, the creditor suspects the company is insolvent, and receives payment of their debt (or part of it) ahead of other creditors. To be an unfair preference, the payment must put the creditor receiving it in a more favourable position than other unsecured creditors.

Not all payments from the company to a creditor in the six months before liquidation are unfair preferences. The Corporations Act provides various defences to an unfair preference claim.

If a liquidator seeks to recover a payment that has been made to you, you may wish to obtain independent legal advice on the merits of the liquidator’s claim before repaying any money.

Creditors’ meetings

A liquidator may call a creditors’ meeting from time to time to inform creditors of the progress of the liquidation, to find out their wishes on a particular matter or seek approval of the liquidator’s fees.

You may also use a creditors’ meeting to ask questions about the liquidation and inform the liquidator about your knowledge of the company’s affairs.

Meetings during a court liquidation

In a court liquidation, the liquidator is not required to call a creditors’ meeting unless a matter requires creditor approval.

The only exception is that if the creditors pass a resolution requiring a creditors’ meeting to be called, or at least one-tenth in value of all the creditors request the liquidator in writing to do so, the liquidator must call a creditors’ meeting. However, it is unusual for this to happen, as those who make the request or pass the resolution must pay the costs of calling and holding the meeting.

Meetings during a creditors’ voluntary liquidation

In a creditors’ voluntary liquidation, the liquidator may choose to hold an annual meeting of the creditors or lodge a report with ASIC on the progress in the administration. If they choose not to hold the meeting, the liquidator must tell creditors that the report has been prepared and give them a copy free of charge if asked. The report must set out:

- an account of the liquidator’s acts and dealings and the conduct of the winding up in the preceding year
- a summary of the tasks yet to be done in the liquidation, and
- an estimate of when the liquidation is expected to be finalised.

The liquidator in a creditors’ voluntary winding up must also hold a joint meeting of the creditors and members at the end of the winding up. Creditors can require the liquidator to call a creditors’ meeting at other times, the same as in a court liquidation, as long as they pay the associated costs.

Minutes of meetings

The chairperson of a creditors’ meeting (usually the liquidator or one of their senior staff) must prepare minutes of the meeting and a record of those who were present at the meeting and lodge them with ASIC within one month. A copy may be obtained from any ASIC Business Centre on payment of the relevant fee.

Voting at a creditors' meeting

To vote at a creditors' meeting you must lodge details of your debt or claim with the liquidator. Often, the liquidator will provide you with a form called a 'proof of debt' to be completed and returned before the meeting. Proofs of debt are discussed further below.

The chairperson of the meeting decides whether or not to accept the debt or claim for voting purposes. The chairperson may decide that a creditor does not have a valid claim or the amount of the debt cannot be determined with any certainty at the date of the meeting. In this case, they may not allow the creditor to vote at all, or only to vote for a debt of $1. This decision is only for voting purposes. It is not relevant to whether a creditor will receive a dividend.

An appeal against a decision by the chairperson to accept or reject a proof of debt or claim for voting purposes may be made to the court within 14 days after the decision.

Voting by proxy

You may appoint a proxy to attend and vote at a meeting on your behalf. A proxy can be any person who is at least 18 years old. Creditors who are companies will have to nominate a person as proxy so that they can participate in the meeting. This is done using a form sent out with the notice of meeting. The completed proxy form must be provided to the liquidator before the meeting. You can fax the proxy form to the liquidator, but must lodge the original within 72 hours of sending the faxed copy.

An electronic form of proxy may be used if the liquidator allows electronic lodgement provided there is a way to authenticate the appointment of the proxy (e.g. by scanning and emailing a signature or using a digital signature).

You can specify on the proxy form how the proxy is to vote on a particular resolution and the proxy must vote in accordance with that instruction. This is called a 'special proxy'. Alternatively, you can leave it to the proxy to decide how to vote on each of the resolutions put before the meeting. This is called a 'general proxy'.

You can appoint the chairperson to represent you either through a special or general proxy. The liquidator or one of their partners or employees must not use a general proxy to vote in favour of a resolution approving payment of the liquidator's fees.

Manner of voting

A vote on any resolution put to a creditors' meeting may be taken by creditors stating aloud their agreement or disagreement, or by a show of hands. Sometimes a more formal voting procedure called a 'poll' is taken.

If voting is by show of hands or by verbally signalling agreement, the resolution is passed if a majority of those present indicate agreement. It is up to the chairperson to decide if this majority has been reached.

After the vote, the chairperson must tell those present whether the resolution has been passed or lost.

The chairperson may decide to conduct a poll, or a poll can be demanded by at least two people present who are entitled to vote, or someone who holds more than 10% of the votes of those entitled to vote at the meeting. The chairperson will determine how this poll is taken.

If you intend to demand that a poll be taken, you must do so before, or as soon as, the chairperson has declared the result of a vote taken by show of hands or voices.

When a poll is conducted, a resolution is passed if:

- more than half the number of creditors who are voting (in person or by proxy) vote in favour of the resolution, and
- those creditors who are owed more than half of the total debt owed to creditors at the meeting vote in favour of the resolution.

This is referred to as a ‘majority in number and value’. If no result is reached, the chairperson has a casting vote.

Chairperson’s casting vote

When a poll is taken and there is a deadlock, the chairperson may use their casting vote either in favour of or against the resolution. The chairperson may also decide not to use their casting vote.

The chairperson must inform the meeting of the reasons why they cast the vote a particular way or why they chose not to use their casting vote. They must also include these reasons in the written minutes of meeting that are lodged with ASIC.

If you are dissatisfied with how the chairperson exercised their casting vote or failed to use their casting vote, you may apply to court for a review of the chairperson’s decision. The court may vary or set aside the resolution or order that the resolution is taken to have been passed.

Votes of related creditors

Directors and shareholders, their spouses and relatives and other entities controlled by them are entitled to attend and vote at creditors’ meetings if they are creditors of the company.

If a resolution is passed, or defeated, based on the votes of these related creditors, and you are dissatisfied with the outcome, you may apply to court for the resolution to be set aside and/or for a fresh resolution to be voted on without related creditors being entitled to vote. Certain criteria must be met before the court will make such an order (e.g. the original result of the vote being against the interests of all or a class of creditors).

Committee of inspection

In both types of liquidation, the liquidator may ask creditors if they wish to appoint a committee of inspection and, if so, who will represent the creditors on the committee.

A committee of inspection assists the liquidator, approves fees and, in limited circumstances, approves the use of some of the liquidator’s powers, on behalf of all the creditors.

Committee meetings can be arranged at short notice, which allows the liquidator to quickly obtain the committee’s views on urgent matters. Shareholders may also be members of the committee.

At the first meeting in a creditors’ voluntary liquidation, creditors can decide to appoint a committee of inspection.

Creditors in both types of liquidation can also request at any time that the liquidator call separate meetings of shareholders and creditors to decide whether a committee of inspection should be appointed and, if so, who will represent the shareholders and creditors on the committee. This doesn’t usually happen, as the creditor making the request must pay the costs of calling and holding these meetings.

A member of the committee of inspection must not, without permission from the court, accept a gift or benefit from the company or any other person, including another creditor, or purchase any of the company’s property.

A committee of inspection acts by a majority in number of its members present at a meeting, but it can only act if a majority of its members attend.

A liquidator must consider any directions given by the committee of inspection, but is not bound to follow them.

Minutes of committee of inspection meetings must be prepared and lodged with ASIC within one month. A copy may be obtained from any ASIC Business Centre on payment of the relevant fee.

Approval of liquidator's fees

A liquidator is entitled to be paid for the work carried out on the liquidation, but only if there are assets available. The liquidator cannot be paid until the amount of fees has been approved by one of the methods set out in the Corporations Act.

In a court liquidation, the amount of fees is approved by:

- agreement with a committee of inspection (if there is one), or
- a resolution passed at a creditors' meeting, or
- the court.

The liquidator must try to get approval by each of these methods, in turn.

In a creditors' voluntary liquidation, a committee of inspection or creditors may approve the fees.

If no fees have been approved in a court liquidation or a creditors' voluntary winding up, the liquidator may draw fees to a maximum of $5000 where they have called a meeting of creditors but not obtained approval for their fees because the meeting did not have a quorum.

The court has the power to review the amount of fees approved.

If you are asked to approve fees, either at a meeting of a committee of inspection or in a general meeting of creditors, the liquidator must give you, at the same time as the notice of the meeting, a report that contains sufficient information for you to assess whether the fees claimed are reasonable. This report should be in simple language and set out:

- a description of the major tasks performed
- the costs of completing these tasks, and
- such other information that will assist in assessing the reasonableness of the fees claimed.

For further information, see Information Sheet 85 *Approving fees: a guide for creditors* (INFO 85).

If you are in any doubt about how the fees were calculated, ask the liquidator for more information.

In a court liquidation, the liquidator must also send creditors a statement of all receipts and payments for the liquidation.

Apart from fees, the liquidator will also be entitled to reimbursement for out-of-pocket expenses that have arisen in carrying out the liquidation. This reimbursement does not require committee, creditor or court approval. However, creditors have a right to know what funds were spent on these costs and why they were spent.

Payment of dividends

If there are funds left over after payment of the costs of the liquidation, and payments to other priority creditors, including employees, the liquidator will pay these to unsecured creditors as a dividend. Generally, the order in which funds are distributed is:

1. costs and expenses of the liquidation, including liquidators' fees
2. outstanding employee wages and superannuation
3. outstanding employee leave of absence (including annual leave, sick leave—where applicable—and long service leave)
4. employee retrenchment pay, and
5. unsecured creditors.

Each category is paid in full before the next category is paid. If there are insufficient funds to pay a category in full, the available funds are paid on a pro rata basis (and the next category or categories will be paid nothing).

Proving your debt

Before any dividend is paid to you for your debt or claim, you will need to give the liquidator sufficient information to prove your debt.

The liquidator will notify you if there are likely to be funds available for distribution and must call for formal proof of debt forms to be lodged. At least 14 days notice of the deadline for lodging the proof must be given.

This notice must be given to each person claiming to be a creditor whose debt or claim has not already been admitted by the liquidator. It must also be published in a daily newspaper in the states where the company carried out its business. A copy of the formal proof of debt form will be sent to you with the notice.

You should attach copies of any relevant invoices or other supporting documents to the proof of debt form, as your debt or claim may be rejected if there is insufficient evidence to support it.

If a creditor is a company, the proof of debt form must be signed by a person authorised by the company to do so.

The completed proof of debt form must be delivered or posted to the liquidator. When submitting your claim, ask the liquidator to acknowledge receipt of your claim and advise if any further information is needed.

The liquidator must notify you within seven days if they reject your claim. If you are dissatisfied with the decision, your first step should be to promptly contact the liquidator to see if you can resolve the matter.

If you can't resolve the matter with the liquidator, you may wish to seek your own legal advice, as you have a limited time to appeal to the court. The liquidator will notify you of this time in the notice of rejection. It must be at least 14 days after you receive the notice. The court has the power to extend the time to appeal. If you don't appeal within this time, the liquidator's decision on your claim is final.

If you have a query regarding the calculation of your claim, or the timing of the payment, discuss this with the liquidator.

Other creditor rights

As well as the various rights involving meetings and participation in dividends discussed above, the other rights of unsecured creditors include the right to:

- receive written reports to creditors about the liquidation
- inspect certain books of the liquidator
- inform the liquidator about your knowledge of matters relevant to the affairs of the company in liquidation, and
- complain to ASIC or the court about the liquidator's conduct in connection with their duties.

Written reports

The number of written reports a liquidator sends to creditors about the liquidation varies. If there are no funds at all available in the liquidation, it is possible that no written report will be sent, although many liquidators will send creditors a brief report even if there are no funds.

Liquidator's books

Liquidators must keep sufficient books to give a complete and correct record of their administration of the company's affairs. These include minutes of meetings and details of all the receipts and payments for the liquidation. These books must be available at the liquidator's office for inspection by creditors and shareholders.

Copies of minutes of meetings and six-monthly detailed lists of receipts and payments, as well as a number of other documents, must also be lodged with ASIC. Copies may be obtained from any ASIC Business Centre on payment of the relevant fee.

Creditors are unable to access the company's books and records without court permission.

Informing the liquidator

The liquidator must report to ASIC if they suspect that anyone connected to the company may have committed an offence. If you have any information that might assist in preparing such a report, you should let the liquidator know.

These reports are not available for inspection. ASIC reviews these reports and decides whether to take further action, such as banning a person from acting as a company director for a period of time or charging the person with a criminal offence.

Applications to the court

Creditors can apply to the court if they are dissatisfied with an act, omission or decision of a liquidator. This includes if a creditor seeks:

- to challenge the liquidator's decision not to admit a proof of debt or claim, either for voting or dividend purposes, and
- a review of the liquidator's fees, in certain circumstances.

Making an application to the court can be costly. You should attempt to resolve any problems with the liquidator and only go to court if this fails.

Liquidators, ASIC and other people can also make applications to the court. For example, a liquidator might apply to have questions decided or powers exercised in a liquidation.

Complaining to ASIC about a liquidator's conduct is discussed below.

Secured creditors' rights

If a company fails to meet its obligations under a security interest (e.g. a charge or a mortgage), a secured creditor can appoint an independent and suitably qualified person (a receiver) to take control of and realise some or all of the secured assets, in order to repay the secured creditor's debt. This right continues after the company goes into liquidation. For more on receivership, see Information Sheet 54 *Receivership: a guide for creditors* (INFO 54).

Another option available to a secured creditor is to ask the liquidator to deal with the secured assets for them and account to them for the proceeds and costs of collecting and selling those assets.

A secured creditor is entitled to vote at creditors' meetings for the amount the company owes them that exceeds the amount they are likely to receive from realisation of the secured assets. The secured creditor can participate in any dividend to unsecured creditors on a similar basis.

Directors and liquidation

Directors cannot use their powers after a liquidator has been appointed. They have an obligation to assist the liquidator by:

- advising the liquidator of the location of company property and delivering any such property in their possession to the liquidator
- providing the company's books and records to the liquidator
- advising the liquidator of the whereabouts of other company records
- providing a written report about the company's business, property and financial circumstances within 14 days of the appointment of the liquidator by the court or within 7 days of the appointment of a liquidator in a creditors' voluntary liquidation
- meeting with, or reporting to, the liquidator to help them with their enquiries, as reasonably required, and
- if required by the liquidator, attending a creditors' meeting to provide information about the company and its business, property, affairs and financial circumstances.

A liquidator has the power to apply to the court to conduct a public examination, under oath, of a director (or other person with information about the company).

Compensation proceedings for amounts lost by creditors as a result of the company trading while insolvent can be initiated against a director personally by ASIC, a liquidator or, in certain circumstances, a creditor.

Conclusion of liquidation

A liquidation effectively comes to an end when the liquidator has realised and distributed all the company's available property and made their report to ASIC.

In a creditors' voluntary liquidation, the liquidator must hold a final joint meeting of the creditors and members to give an account of how the liquidation has been conducted and how company property has been disposed of. After the final meeting is held, the company is automatically deregistered by ASIC three months after a notice of the holding of the meeting is lodged.

In a court liquidation, the liquidator is not required to hold a final meeting of creditors. After the liquidator decides that the company's affairs are fully wound up, they may:

- seek an order for release from the court
- seek an order for release and that ASIC deregister the company, or
- if there are insufficient assets to obtain a court order for the company's deregistration, request that ASIC deregister the company.

A company ceases to exist after it has been deregistered.

Queries and complaints

You should first raise any queries or complaints with the liquidator. If this fails to resolve your concerns, including any concerns about the liquidator's conduct, you can lodge a complaint with ASIC at www.asic.gov.au/complain, or write to:

ASIC Complaints
PO Box 9149
TRARALGON VIC 3844

ASIC will usually not become involved in matters of commercial judgement by a liquidator. Complaints against companies and their officers can also be made to ASIC. For other enquiries, visit www.asic.gov.au/question, or call ASIC on 1300 300 630 for the cost of a local call.

To find out more

For an explanation of terms used in this information sheet, see Information Sheet 41 *Insolvency: a glossary of terms* (INFO 41). For more on external administration, see ASIC's related information sheets at www.asic.gov.au/insolvencyinfosheets:

- INFO 74 *Voluntary administration: a guide for creditors*
- INFO 75 *Voluntary administration: a guide for employees*
- INFO 46 *Liquidation: a guide for employees*
- INFO 54 *Receivership: a guide for creditors*
- INFO 55 *Receivership: a guide for employees*
- INFO 43 *Insolvency: a guide for shareholders*
- INFO 42 *Insolvency: a guide for directors*
- INFO 84 *Independence of external administrators: a guide for creditors*
- INFO 85 *Approving fees: a guide for creditors*

These are also available from the Insolvency Practitioners Association (IPA) website at www.ipaa.com.au. The IPA website also contains the IPA's Code of Professional Practice for Insolvency Professionals, which applies to IPA members.

Important note

This information sheet contains a summary of basic information on the topic. It is not a substitute for legal advice. Some provisions of the law referred to may have important exceptions or qualifications. This document may not contain all of the information about the law or the exceptions and qualifications that are relevant to your circumstances. You will need a qualified professional adviser to take into account your particular circumstances and to tell you how the law applies to you.

INFORMATION SHEET 74

Voluntary administration: a guide for creditors

If a company is in financial difficulty, it can be put into voluntary administration.

This information sheet provides general information for unsecured creditors of companies in voluntary administration.

Who is a creditor?

You are a creditor of a company if the company owes you money. Usually, a creditor is owed money because they have provided goods or services, or made loans to the company.

An employee owed money for unpaid wages and other entitlements is a creditor.

A person who may be owed money by the company if a certain event occurs (e.g. if they succeed in a legal claim against the company) is also a creditor, and is sometimes referred to as a 'contingent' creditor. There are generally two categories of creditor: secured and unsecured:

- A secured creditor is someone who has a 'charge', such as a mortgage, over some or all of the company's assets, to secure a debt owed by the company. Lenders usually require a charge over company assets when they provide a loan.
- An unsecured creditor is a creditor who does not have a charge over the company's assets.

Employees are a special class of unsecured creditors. Their outstanding entitlements are usually paid in priority to the claims of other unsecured creditors. If you are an employee, see ASIC's information sheet INFO 75 *Voluntary administration: a guide for employees*.

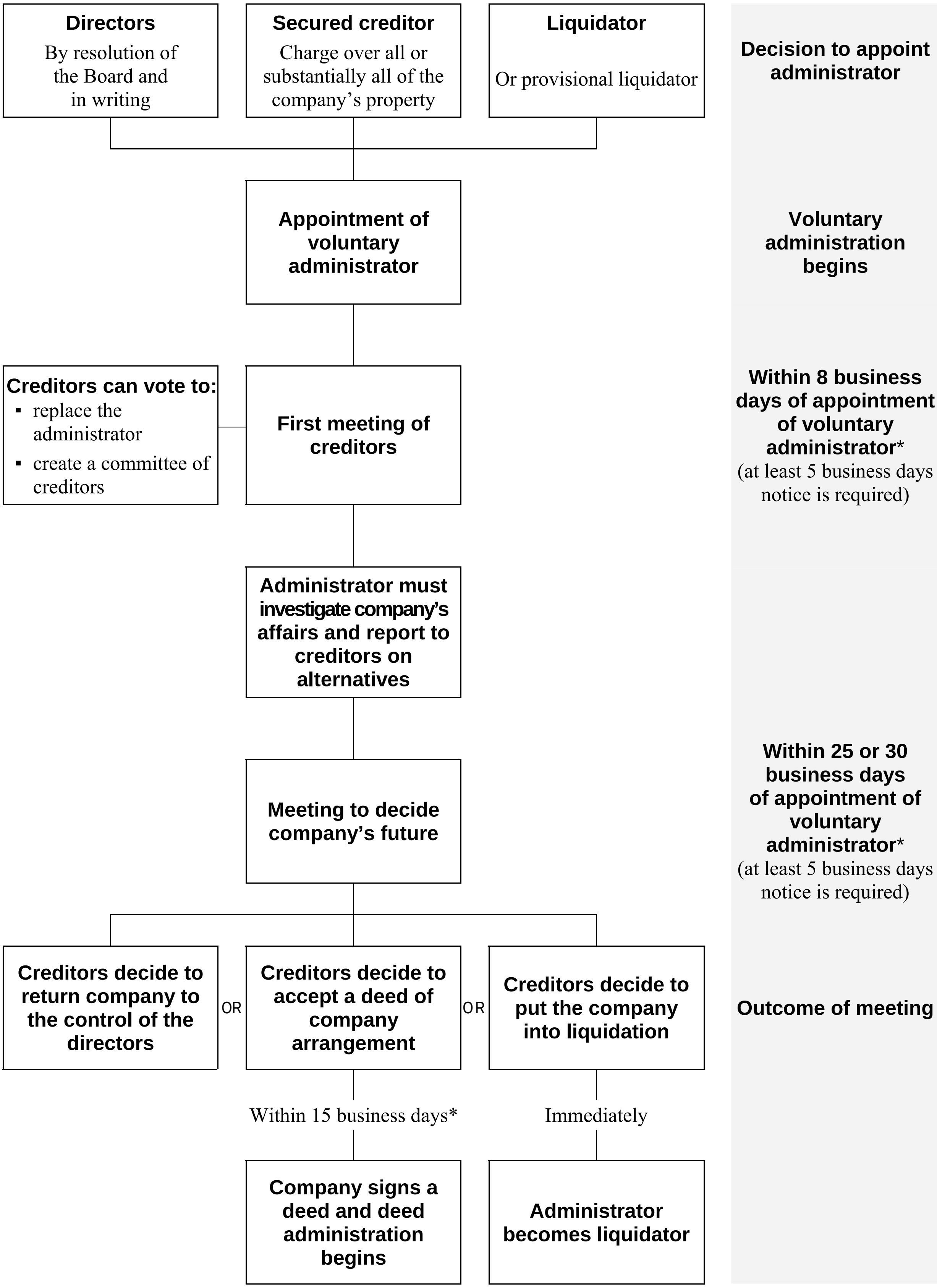
The purpose of voluntary administration

Voluntary administration is designed to resolve a company's future direction quickly (Figure 1 summarises the process). An independent and suitably qualified person (the voluntary administrator) takes full control of the company to try to work out a way to save either the company or its business.

If it isn't possible to save the company or its business, 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 instead been placed straight into liquidation. A mechanism for achieving these aims is a deed of company arrangement.

A voluntary administrator is usually appointed by a company's directors, after they decide that the company is insolvent or likely to become insolvent. Less commonly, a voluntary administrator may be appointed by a liquidator, provisional liquidator, or a secured creditor.

Figure 1: The voluntary administration process



* Unless the court allows an extension of time.

A company in voluntary administration may also be in receivership: see ASIC information sheet INFO 54 *Receivership: a guide for creditors*.

The voluntary administrator's role

After taking control of the company, the voluntary administrator investigates and reports to creditors on the company's business, property, affairs and financial circumstances, and on the three options available to creditors. These are:

- end the 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.

In doing so, the voluntary administrator tries to work out the best solution to the company's problems, assesses any proposals put forward by others for the company's future, and compares the possible outcomes of the proposals with the likely outcome in a liquidation.

A creditors' meeting is usually held about five weeks after the company goes into voluntary administration to decide on the best option for the company's future. In complex administrations, this meeting may be held later if the court consents.

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.

Another responsibility of the voluntary administrator is to report to ASIC on possible offences by people involved with the company.

Although the voluntary administrator may be appointed by the directors, they must act fairly and impartially.

Effect of appointment

The effect of the appointment of a voluntary administrator is to provide the company with breathing space while the company's future is resolved. While the company is in voluntary administration:

- unsecured creditors can't begin, continue or enforce their claims against the company without the administrator's consent or the court's permission
- owners of property (other than perishable property) used or occupied by the company, or people who lease such property to the company, can't recover their property
- except in limited circumstances, secured creditors can't enforce their charge over company property
- a court application to put the company in liquidation can't be commenced, and
- a creditor holding a personal guarantee from the company's director or other person can't act under the personal guarantee without the court's consent.

Voluntary administrator's liability

Any debts that arise from the voluntary administrator purchasing goods or services, or hiring, leasing, using or occupying property, are paid from the available assets as costs of the voluntary administration. If there are insufficient funds available from asset realisations to pay these costs, the voluntary administrator is personally liable for the shortfall. To have the benefit of this protection, you should ensure you receive a purchase order authorised in the manner advised by the voluntary administrator.

The voluntary administrator must also decide whether to continue to use or occupy property owned by another party that is held or occupied by the company at the time of their appointment.

Within five business days after their appointment, the voluntary administrator must notify the owner of property whether they intend to continue to occupy or use the property. If the voluntary administrator decides to continue to do so, they will be personally liable for any rent or amounts payable arising after the end of the five business days.

Amounts that become due to employees after the date of the appointment of the voluntary administrator have a priority claim against the company's assets as a cost of the administration. However, the voluntary administrator does not become personally liable for such amounts unless the voluntary administrator adopts employees' contracts of employment or enters into new employment contracts with them.

Creditors' meetings

Two meetings of creditors must be held during the voluntary administration.

First creditors' meeting

The voluntary administrator must call the first creditors' meeting within eight business days after the voluntary administration begins.

At least five business days before the meeting, the voluntary administrator must notify as many creditors as practical in writing and advertise the meeting. The advertisement must appear in a newspaper circulating in the states or territories in which the company has its registered office or carries on its business.

The voluntary administrator must send to creditors, with the notice of meeting, declarations about any relationships they may have, or indemnities they have been given, to allow creditors to consider the voluntary administrator's independence and make an informed decision about whether they want to replace them with another voluntary administrator of the creditors' choice.

The purpose of the first meeting is for creditors to decide two questions:

- whether they want to form a committee of creditors, and, if so, who will be on the committee, and
- whether they want the existing voluntary administrator to be removed and replaced by a voluntary administrator of their choice.

The role of a committee of creditors is to consult with the voluntary administrator about matters relevant to the voluntary administration and receive and consider reports from the voluntary administrator. The committee can also require the voluntary administrator to report to them about the voluntary administration. It may also approve the voluntary administrator's fees.

A creditor who wishes to nominate an alternative voluntary administrator must approach a registered liquidator before the meeting and get a written consent from that person that they would be prepared to act as voluntary administrator. The proposed alternative administrator should give to the meeting declarations about any relationships they may have, or indemnities they have been given. The voluntary administrator will only be replaced if the resolution to replace them is passed by the creditors at the meeting.

To be eligible to vote at this meeting, you must lodge details of your debt or claim with the voluntary administrator (discussed further below).

This meeting can be chaired by either the voluntary administrator or one of their senior staff.

Second creditors' meeting (to decide the company's future)

After investigating the affairs of the company and forming an opinion on each of the three options available to creditors (outlined above), including an opinion as to which option is in the best interests of creditors, the administrator must call a second creditors' meeting. At this meeting, creditors are given the opportunity to decide the company's future.

This meeting is usually held about five weeks after the company goes into voluntary administration (six weeks at Christmas and Easter).

However, in complex voluntary administrations, often more time is needed for the voluntary administrator to be in a position to report to creditors. In these circumstances, the court can approve an extension of time to hold the meeting.

The voluntary administrator must chair this meeting.

In preparation for the second meeting, the voluntary administrator must send creditors the following documents at least five business days before the meeting:

- a notice of meeting
- the voluntary administrator's report, and
- a statement about any proposals for a deed of company arrangement.

These will be accompanied by:

- a claim form (usually a 'proof of debt' form), and
- a proxy voting form.

The meeting must also be advertised.

Either or both the first and second creditors' meeting may be held using telephone or videoconferencing facilities.

Voluntary administrator's report

You should read the voluntary administrator's report before you attend the second meeting or decide whether you want to appoint someone else to vote on your behalf at that meeting. This report must give sufficient information to explain the company's business, property and affairs, and the reasons for the current financial situation, to enable you to make an informed decision about the company's future.

The report should also provide an analysis of any proposals for the future of the company, including the possible outcomes, as well as a comparable estimate of what would be available for creditors in a liquidation.

Finally, the report should include the voluntary administrator's opinion on each of the options available to creditors, as well as an opinion on which is in the best interests of creditors. As noted above, the options are:

- end the voluntary administration and return the company to the directors' control
- approve a deed of company arrangement (if one is proposed), or
- put the company into liquidation.

Voluntary administrator's statement about deed

If there are proposals for a deed of company arrangement, the voluntary administrator must provide creditors with a statement giving enough details of each proposal to enable creditors to make an informed decision. The types of proposals allowed in a deed of company arrangement are very flexible.

Typically, a proposal will provide for the company to pay all or part of its debts, possibly over time, and then be free of those debts. It will often provide for the company to continue trading. How these things will happen varies from case to case, as the terms allowed in a deed of company arrangement are also very flexible. The contents of a deed of company arrangement are discussed below.

You should insist on being provided with as much information about the terms of the proposed deed as possible, before the creditors' meeting. The minimum contents of a deed of company arrangement, discussed below, provide a guide on the information you might request if it hasn't already been provided.

You should also contact the voluntary administrator before the meeting if you believe the report to creditors does not contain sufficient information to enable you to make a decision about the company's future.

Voting at a creditors' meeting

To vote at any creditors' meeting you must lodge details of your debt or claim with the voluntary administrator. Usually, the voluntary administrator will provide you with a form called a 'proof of debt' to be completed and returned before the meeting.

The chairperson of the meeting decides whether or not to accept the debt or claim for voting purposes. The chairperson may decide that a creditor does not have a valid claim or the amount of the debt cannot be determined with any certainty at the date of the meeting. In this case, they may not allow the creditor to vote at all, or only to vote for a debt of $1. This decision is only for voting purposes. It is not relevant to whether a creditor will receive a dividend.

An appeal against a decision by the chairperson to accept or reject a proof of debt or claim for voting purposes may be made to the court within 14 days after the decision.

A secured creditor is entitled to vote for the full amount of their debt without having to deduct the value of their security.

Voting by proxy

You may appoint a proxy to attend and vote at a meeting on your behalf. A proxy can be any person who is at least 18 years old. Creditors who are companies will have to nominate a person as proxy so that they can participate in the meeting. This is done using a form sent out with the notice of meeting. The completed proxy form must be provided to the voluntary administrator before the meeting. You can fax the proxy form to the voluntary administrator, but must lodge the original within 72 hours of sending the faxed copy.

An electronic form of proxy may be used if the liquidator allows electronic lodgement, provided there is a way to authenticate the appointment of the proxy (e.g. by scanning and e-mailing a signature or using a digital signature).

You can specify on the proxy form how the proxy is to vote on a particular resolution and the proxy must vote in accordance with that instruction. This is called a 'special proxy'. Alternatively, you can leave it to the proxy to decide how to vote on each of the resolutions put before the meeting. This is called a 'general proxy'.

You can appoint the chairperson to represent you either through a special or general proxy. The voluntary administrator or one of their partners or employees must not use a general proxy to vote in favour of a resolution approving payment of the voluntary administrator's fees.

Manner of voting

A vote on any resolution put to a creditors' meeting may be taken by creditors stating aloud their agreement or disagreement, or by a show of hands. Sometimes a more formal voting procedure called a 'poll' is taken.

If voting is by show of hands or by verbally signalling agreement, the resolution is passed if a majority of those present indicate agreement. It is up to the chairperson to decide if this majority has been reached.

After the vote, the chairperson must tell those present whether the resolution has been passed or lost. If the chairperson is unable to determine the outcome of a resolution on a show of hands, they may decide to conduct a poll.

Alternatively, a poll can be demanded by at least two people present who are entitled to vote, or someone who holds more than 10% of the votes of those entitled to vote at the meeting. The chairperson will determine how this poll is taken.

If you intend to demand that a poll be taken, you must do so before, or as soon as, the chairperson has declared the result of a vote taken by show of hands or voices.

When a poll is conducted, a resolution is passed if:

- more than half the number of creditors who are voting (in person or by proxy) vote in favour of the resolution, and
- those creditors who are owed more than half of the total debt owed to creditors at the meeting vote in favour of the resolution.

This is referred to as a 'majority in number and value'. If a majority in both number and value is not reached under a poll (often referred to as a deadlock), the chairperson has a casting vote.

Chairperson's casting vote

When a poll is taken and there is a deadlock, the chairperson may use their casting vote either in favour of or against the resolution. The chairperson may also decide not to use their casting vote.

The chairperson must inform the meeting, and include in the written minutes of meeting that are lodged with ASIC, of the reasons why they cast their vote in a particular way or why they chose not to use their casting vote.

If you are dissatisfied with how the chairperson exercised their casting vote or failed to use their casting vote, you may apply to the court for a review of the chairperson's decision. The court may vary or set aside the resolution or order that the resolution is taken to have been passed.

Votes of related creditors

If directors and shareholders, their spouses and relatives and other entities controlled by them are creditors of the company, they are entitled to attend and vote at creditors' meetings, including the meeting to decide the company's future.

If a resolution is passed, or defeated, based on the votes of these related creditors, and you are dissatisfied with the outcome, you may apply to the court for the resolution to be set aside and/or for a fresh resolution to be voted on without related creditors being entitled to vote. Certain criteria must be met before the court will make such an order (e.g. the original result of the vote being against the interests of all or a class of creditors).

Deciding how to vote at the second meeting

How you vote at the meeting on the three possible options, including any competing proposals for a deed of company arrangement, is a commercial decision based on your assessment of the company and its future prospects, and your personal circumstances. The information provided by the voluntary administrator, including opinions expressed, will assist you. However, you are not obliged to accept the administrator's recommendation.

If you do not consider that you have been given enough information to decide how to vote, and particularly whether to vote for any deed proposal, you can ask for a resolution to be put to creditors that the meeting be adjourned (up to a maximum of 45 business days in total) and for the administrator to provide more information. You must make this request before a vote on the company's future. This resolution must be passed for the adjournment to take place.

Creditors also have the right when a deed of company arrangement is proposed and considered at the meeting to negotiate specific requirements into the terms of the deed, including, for example, how the deed administrator is to report to them on the progress of the deed.

Any request to vary the deed proposal to include such requirements should be made before the deed proposal is voted on.

Minutes of meeting

The chairperson must prepare minutes of each meeting and a record of those who were present at each meeting.

The minutes must be lodged with ASIC within 14 days of the meeting. A copy may be obtained from any ASIC Business Centre on payment of the relevant fee.

Company returned to directors

If the company is returned to the directors, they will be responsible for ensuring that the company pays its outstanding debts as they fall due. It is only in very rare circumstances that creditors will resolve to return the company to the control of its directors.

Liquidation

If creditors resolve that the company go into liquidation, the voluntary administrator becomes the liquidator unless creditors vote at the second meeting to appoint a different liquidator of their choice. The liquidation proceeds as a creditors' voluntary liquidation with any payments of dividends to creditors made in the order set out in the *Corporations Act 2001* (Corporations Act). To find out more, see ASIC information sheet INFO 45 *Liquidation: a guide for creditors*.

Deed of company arrangement

If creditors vote for a proposal that the company enter a deed of company arrangement, the company must sign the deed within 15 business days of the creditors' meeting, unless the court allows a longer time. If this doesn't happen, the company will automatically go into liquidation, with the voluntary administrator becoming the liquidator.

The deed of company arrangement binds all unsecured creditors, even if they voted against the proposal. It also binds owners of property, those who lease property to the company and secured creditors, if they voted in favour of the deed. In certain circumstances, the court can also order that these people are bound by the deed even if they didn't vote for it. The deed of company arrangement does not prevent a creditor who holds a personal guarantee from the company's director or another person taking action under the personal guarantee to be repaid their debt.

Contents of the deed

Whatever the nature of the deed of company arrangement, it must contain certain information, including:

- the name of the deed administrator
- the property that will be used to pay creditors
- the debts covered by the deed and the extent to which those debts are released
- the order in which the available funds will be paid to creditors (the deed of company arrangement must ensure that employees have a priority in payment of outstanding employee entitlements unless the eligible employees agree by a majority in both number and value to vary this priority)
- the nature and duration of any suspension of rights against the company
- the conditions (if any) for the deed to come into operation
- the conditions (if any) for the deed to continue in operation, and
- the circumstances in which the deed terminates.

There are also certain terms that will be automatically included in the deed, unless the deed says they will not apply. These are called the ‘prescribed provisions’. They include such matters as the powers of the deed administrator, termination of the deed and the appointment of a committee of creditors (called a ‘committee of inspection’).

The voluntary administrator’s report should tell you which prescribed provisions are proposed to be excluded or varied, and, if varied, how.

Monitoring the deed

It is the role of the deed administrator to ensure the company (or others who have made commitments under the deed) carries through these commitments. The extent of the deed administrator’s ongoing role will be set out in the deed.

Creditors can also play a role in monitoring the deed. If you are concerned that the obligations of the company (or others) under the deed are not being met, you should take this up promptly with the deed administrator. Matters that may give rise for concern include deadlines for payments or other actions promised under the deed being missed.

Creditors also have the right when a deed of company arrangement is proposed and considered at the second meeting to negotiate consequences of failure to meet such deadlines into the terms of the deed. Any request to vary the deed proposal to include such consequences should be made before the deed proposal is voted on.

The deed administrator must lodge a detailed list of receipts and payments with ASIC every six months.

Varying the deed

The deed administrator can call a creditors’ meeting at any time to consider a proposed variation to the deed or a resolution to terminate the deed. The proposed resolutions must be set out in the notice of meeting sent to creditors.

Creditors owed at least 10% in value of all creditor claims can, by written request, also require the deed administrator to call such a meeting. However, it is unusual for this to happen, as those who make the request must pay the costs of calling and holding the meeting.

Payment of dividends under a deed

The order in which creditor claims are paid depends on the terms of the deed. Sometimes the deed proposal is for creditor claims to be paid in the same priority as in a liquidation. Other times, a different priority is proposed.

The deed must ensure employee entitlements are paid in priority to other unsecured creditors unless eligible employees have agreed to vary their priority.

Before you decide how to vote at the creditors' meeting, make sure you understand how the deed will affect the priority of payment of your debt or claim.

You may wish to seek independent legal advice if the deed proposes a different priority to that in a liquidation, or if creditors approve such a deed.

Establishing your claim under a deed

How debts or claims are dealt with under a deed of company arrangement depends on the deed's terms. Sometimes the deed incorporates the Corporations Act provisions for dealing with debts or claims in a liquidation.

Before any dividend is paid to you for your debt or claim, you will need to give the deed administrator sufficient information to prove your debt. You may be required to complete a claim form (this is called a 'proof of debt' in a liquidation). You should attach copies of any relevant invoices or other supporting documents to the claim form, as your debt or claim may be rejected if there is insufficient evidence to support it.

If a creditor is a company, the claim form should be signed by a person authorised by the company to do so.

When submitting a claim, you may ask the deed administrator to acknowledge receipt of your claim and advise if any further information is needed.

If the deed administrator rejects your claim after you have taken the above steps, first contact the deed administrator. You may also wish to seek your own legal advice. This should be done promptly. Depending on the terms of the deed, you may have a limited time in which to take legal action to challenge the decision.

If you have a query about the timing of the payment, discuss this with the deed administrator.

How a deed comes to an end

A deed may come to an end because the obligations under the deed have all been fulfilled and the creditors have been paid. Alternatively, the deed may set out certain conditions where the deed will automatically terminate.

The deed may also provide that the company will go into liquidation if the deed terminates due to these conditions being met.

Another way for the deed to end is if the deed administrator calls a meeting of creditors, and creditors vote to end the deed. This may occur because it appears unlikely that the terms of the deed can be fulfilled.

At the same time, creditors may be asked to vote to put the company into liquidation.

The deed may also be terminated if a creditor, the company, ASIC or any other interested person applies to the court and the court is satisfied that:

- creditors were provided false and misleading information on which the decision to accept the deed proposal was made
- the voluntary administrator's report left out information that was material to the decision to accept the deed proposal

- the deed cannot proceed without undue delay or injustice, or
- the deed is unfair or discriminatory to the interests of one or more creditors or against the interests of creditors as a whole.

If the court terminates the deed as a result of such an application, the company automatically goes into liquidation.

Approval of administrator's fees

Both a voluntary administrator and deed administrator are entitled to be paid for the work they perform. Generally, their fees will be paid from available assets, before any payments are made to creditors. They may have also arranged for a third party to pay any shortfall in their fees if there aren't enough assets.

The fees cannot be paid until the amount has been approved by a creditors' committee, creditors or the court. Creditors, the voluntary administrator/deed administrator or ASIC can ask the court to review the amount of fees approved.

If you are asked to approve fees, either at a meeting of a creditors' committee or in a general meeting of creditors, the voluntary administrator or deed administrator must give you, at the same time as the notice of the meeting, a report that contains sufficient information for you to assess whether the fees claimed are reasonable. This report should be in simple language and set out:

- a description of the major tasks performed
- the costs of completing these tasks, and
- such other information that will assist in assessing the reasonableness of the fees claimed.

For further information, see ASIC's information sheet INFO 85 *Approving fees: a guide for creditors*. If you are in any doubt about how the fees were calculated, ask for more information.

Apart from fees, the voluntary administrator and deed administrator are entitled to reimbursement for out-of-pocket expenses that have arisen in carrying out their administration. This reimbursement does not usually require approval.

Creditors' committee

A creditor's committee may be formed, following a vote of creditors, to consult with the voluntary administrator or deed administrator and receive reports on the conduct of their administration. A creditors' committee can also approve the administrator's fees.

In a voluntary administration, this committee is called a 'committee of creditors' and may be formed at the first creditors' meeting. While the company is under a deed of company arrangement, it is called a 'committee of inspection'.

All creditors, including a representative of the company's employees, are entitled to stand for committee membership to represent the interests of all creditors. However, to operate efficiently, the committee should not be too large.

If a creditor is a company, the creditor can nominate a director or employee to represent it on the committee.

Directors and voluntary administration

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.

If the company goes from voluntary administration into a deed of company arrangement, the directors' powers depend on the deed's terms. When the deed is completed, the directors regain full control, unless the deed provides for the company to go into liquidation on completion.

If the company goes from voluntary administration or a deed of company arrangement into liquidation, the directors cannot use their powers. If creditors resolve that the voluntary administration should end, control of the company goes back to the directors.

Queries and complaints

You should first raise any queries or complaints with the voluntary administrator or deed administrator. If this fails to resolve your concerns, including any concerns about their conduct, you can lodge a complaint with ASIC at www.asic.gov.au/complain, or write to:

ASIC Complaints
PO Box 9149
TRARALGON VIC 3844

ASIC will usually not become involved in matters of commercial judgement by a voluntary administrator or deed administrator. Complaints against companies and their officers can also be made to ASIC. For other enquiries, email ASIC through infoline@asic.gov.au, or call ASIC's Infoline on 1300 300 630 for the cost of a local call.

To find out more

For an explanation of terms used in this information sheet, see ASIC information sheet INFO 41 *Insolvency: a glossary of terms*. For more on external administration, see ASIC's related information sheets at www.asic.gov.au/insolvencyinfosheets:

- INFO 75 *Voluntary administration: a guide for employees*
- INFO 45 *Liquidation: a guide for creditors*
- INFO 46 *Liquidation: a guide for employees*
- INFO 54 *Receivership: a guide for creditors*
- INFO 55 *Receivership: a guide for employees*
- INFO 43 *Insolvency: a guide for shareholders*
- INFO 42 *Insolvency: a guide for directors*
- INFO 84 *Independence of external administrators: a guide for creditors*
- INFO 85 *Approving fees: a guide for creditors*

These are also available from the Insolvency Practitioners Association (IPA) website at www.ipaa.com.au. The IPA website also contains the IPA's Code of Professional Practice for Insolvency Professionals, which applies to IPA members.