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INSOLVENCY WA

Corporate Insolvency Cheat Sheet

Voluntary Administration / Deed of Company Arrangement

The purpose of a Voluntary Administration is to give time to a company in financial distress to formulate and implement a restructuring plan, or at least, to plan for an orderly realization of the assets of a company.

The appointment of an Administrator is generally made by a resolution passed by the majority of the board of directors, so the administration process can commence quite quickly.

Claims against the company are put on hold whilst the Administrator trades the business (which does not occur in all cases) and investigates the past affairs of the company, including its assets, liabilities, insolvent transactions and potential insolvent trading matters.

The directors / shareholders, or other parties, may propose a Deed of Company Arrangement ("DOCA") for creditors to consider, which is a proposal generally designed to offer a greater return to creditors compared to what would be available if the company were to be wound up (i.e. placed into liquidation). If the DOCA is accepted, the control of the company usually reverts back to its directors.

A DOCA may be founded upon, for example, an injection of third party funds, the withdrawal of related party claims to enhance the return to external creditors, sale of surplus assets or contributions from future trading.

The Administrator prepares a report to creditors which compares the outcomes of the DOCA proposal and the likely outcomes of a liquidation scenario, and creditors vote on the future of the company at a meeting of creditors.

At the creditors meeting, the DOCA proposal can be accepted by creditors. The insolvency appointment that follows is call the Deed Administration. If the proposal is rejected by creditors, the company is most often placed into liquidation.

Ideal Candidate for a Voluntary Administration

- A profitable business were it not for historical accrual of debts
- Early intervention
- Realistic plans for ongoing trading
- Limited tax debts and a strong history of tax compliance
- Grounds for the proposal of a DOCA

Advantages of the VA Process

- The appointment of an Administrator can happen quite quickly if required
- Initial VA phase enforces a moratorium against creditor claims and recovery actions and offers other protective provisions to facilitate financial rehabilitation
- Facilitates ongoing trading of the company
- The DOCA proposal process is quite flexible
- If a DOCA is accepted, it binds all the creditors as opposed to a singular creditor or small group

Disadvantages of the VA Process

- The process is not cheap – costs of being involved in trading (if applicable), two creditors meetings, Administrator's investigations and reporting on recommendation for future direction of the company
- Difficult to achieve success with a DOCA if there are dissenting creditors
- Open to exploitation by directors who propose a DOCA to avoid the scrutiny of a liquidator
- Personal guarantees given by directors are enforceable under a liquidation and DOCA scenario

Creditors' Voluntary Liquidation

The purpose of a Creditors' Voluntary Liquidation is to have a Liquidator take control of the affairs of an insolvent company so that it may be wound up in an orderly fashion for the benefit of stakeholders.

The appointment process initially involves a meeting of directors, followed by an extraordinary meeting of members, where a resolution is passed to appoint a Liquidator. This can happen quite quickly where Consent to Short Notice is agreed to by at least 95% of members.

The Liquidator's role is to:

- Realise the assets of the company
- Make inquiries and conduct investigations into the past affairs of the company in order to ascertain the causes of its demise, pursue recoveries in relation to insolvent transactions and insolvent trading offences, and report findings to the Australian Securities & Investments Commission
- After the costs of the liquidation, and subject to the rights of any secured creditor/s, pay dividends to the creditors of the company, first to priority creditors (including employees) and then to unsecured creditors

Advantages of the Liquidation Process

- Control – to a degree – in that the shareholders appoint a Liquidator of their choice, however the Liquidator's duty is to the body of creditors
- Debts are frozen and handled by the Liquidator
- Stress relief for company officers
- If the company has no assets, eligible employees can claim their unpaid entitlements from the Fair Entitlements Guarantee

Disadvantages of the Liquidation Process

- Trading history is investigated and scrutinized by the Liquidator
- Directors who have given personal guarantees to creditors may face personal bankruptcy

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Members' Voluntary Liquidation

A Members' Voluntary Liquidation is often a tax effective method of bringing the affairs of a solvent company to an end by settling the claims of creditors in full and distributing the surplus assets of the company to its members.

The main reason to commence a Members' Voluntary Liquidation process is to return the capital of the company to the members or to distribute any pre-1985 capital reserves in a tax effective way.

The process to appoint a Liquidator is very important – see below:

Step One – Meeting of Directors

At a meeting of directors a resolution should be passed that a Declaration of Solvency (ASIC Form 520) be signed and that a general meeting of members be called to consider the resolutions that the company be wound up, that the assets be distributed and that a Liquidator be appointed.

Step Two – Lodgement of Declaration of Solvency

The original of the Form 520 (Declaration of Solvency) must be lodged with ASIC before the date on which a notice of meeting of members is sent out.

Step Three – Notice to Members of an Extraordinary General Meeting

Members must receive 21 days' notice of the proposed meeting, unless a Consent to Short Notice is obtained from not less than 95% of the members.

Step Four – Meeting of Members

At the meeting of members, the following resolutions should be passed: that the company be wound up; that a liquidator be appointed; the amount of the liquidator's remuneration; consent for the early destruction of the records of the company upon dissolution of the company.

The Liquidator does not always physically realise assets, as they may be transferred to the members in specie as part of the distribution process.

Before the assets can be distributed, the Liquidator must obtain a tax clearance from the ATO. This usually means the existing taxation accountant will need to complete any outstanding lodgement obligations before tax clearance is granted (i.e. a tax return up the date of liquidation and any other outstanding Business Activity Statements etc). It can take upwards of six weeks to obtain tax clearance from the ATO and the members should be advised of this timeframe before the liquidation commences.

Upon distribution of the assets, the liquidation is finalised and the company is ultimately deregistered by ASIC three months after the Liquidator has completed the process.

Receivership

A Receivership is an insolvency administration where a secured creditor, or in some circumstances the Court, appoints an independent and suitably qualified insolvency practitioner to take control of some or all of a company's assets.

The powers of a Receiver are set out in the *Corporations Act 2001* and the underlying security agreement or Court Orders in the case of Court appointed Receivers.

The Receiver's role is to collect and realise enough of the company's assets to discharge the secured party' debts, subject to the order of priorities when making payments to creditors.

During a Receivership, the Receiver has no obligation to report to unsecured creditors or hold a meeting of creditors; however it is usually the case that the Receiver will contact suppliers and other stakeholders in the event that the business is traded-on.

Occasionally, a Receiver will be appointed by the Court where there is a dispute amongst directors and/or shareholders, in order to preserve the assets of the company.