



Company Insolvency Overview

February 2010

Introduction

1. This overview is a general information guide only to highlight the differences between the various types of external controllers over company assets. Creditors should seek their own advice about specific circumstances since this is not intended to be a summary of the law.

External controller

2. If a company is in financial difficulty an external controller can be appointed by various entities. A Secured Creditor or the Court may put the company under the control of an independent external person who can be a:
 - (a) Administrator;
 - (b) Receiver or a Receiver and Manager,
 - (c) Controller or Managing Controller (Receiver); or
 - (d) Liquidator.

It is possible for a company in receivership to also be placed in liquidation or administration.

Administration

3. Usually a company goes into administration when directors are of the view that the company is insolvent, or is likely to become insolvent. An administrator, who must be a registered liquidator, is appointed.
4. As a rule, the board of the company makes the appointment of an administrator, although it can also be made by a provisional liquidator, a liquidator or a secured creditor with a charge over "all or nearly all" of the company's assets.
5. When an administrator is appointed, the powers of the directors automatically cease. An administrator takes complete control of the company's business, property and affairs and can exercise any power that the company or any of its officers would normally exercise.
6. The law provides a certain period of time to allow the administrator to investigate the company's affairs and to propose an arrangement to creditors. The objective of the administration process is to run the business so as to maximise the chances of the company continuing in existence. And if that is not possible to at least provide a better return for the company's creditors than would result from an immediate winding up of the company.
7. The administrator must form an opinion and make a recommendation to creditors as to whether the company should execute a Deed of Company Arrangement (DOCA), be wound up, or the administration end. It is the creditors who vote on the resolutions and determine the immediate option and the future of the company. The resolution of the majority binds all creditors.

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8. The administrator must form an opinion and make a recommendation to creditors as to whether the company should execute a Deed of Company Arrangement (DOCA), be wound up, or the administration end. It is the creditors who vote on the resolutions and determine the immediate option and the future of the company. The resolution of the majority binds all creditors.
9. If the creditors agree to proposals for a DOCA, the Deed is executed and binds the company and its officers. Control normally reverts at that time to the directors although it is common for changes to take place in the composition of the board. Often the DOCA also limits the powers of the directors and requires that certain activities require the prior approval of the administrator. The court does not need to approve but has safety-net powers.
10. A DOCA generally operates for a sufficient length of time (specified in the Deed) to enable the company to resolve its financial difficulties and repay creditors either in full or as otherwise agreed. When a DOCA is fully effectuated, the company has usually recovered sufficiently for control to revert to the directors and for the board to then seek the re-quotation of the company's shares.
11. If the company fails to fulfil the terms of the Deed a further meeting is convened to either vary or terminate the Deed. If the creditors resolve to terminate the Deed and the company is to be wound up, the administrator usually becomes the liquidator of the company.

Receivership

12. A Receiver is appointed by a Secured Creditor or in special circumstances by the Court. A Secured Creditor is someone to whom the company has given a "charge", over all or part of its assets in return for value, usually loan funds. Anyone can see if a registered charge exists by checking company records at an ASIC Business Centre. The Receiver must collect and look after the company assets over which the Secured Creditor has a charge and sell sufficient assets to discharge the debt owed to the appointing secured creditor.
13. A receiver is a person appointed to collect and receive money. Usually, the person is appointed as a receiver and manager, which means that in addition to having the power to receive money, they have the power to manager the affairs of the company. In this overview, the term receiver is used as an abbreviation for receiver and manager.
14. If the Receiver has been appointed pursuant to a floating charge, the money collected will be applied to:
 - (a) First, pay certain priority claims, including employee entitlements such as wages, superannuation contributions and leave payments;
 - (b) Second, pay the Secured Creditor, and
 - (c) Third, if there are any funds left over, pay the company or its Liquidator, if one has been appointed.
15. The Receiver owes a prime duty to the company's Secured Creditor. The Receiver owes no duty to Unsecured Creditors other than a general duty to the company.
16. In exercising a power of sale in respect of property of a corporation, a controller must take all reasonable care to sell the property for:
 - (a) if, when it is sold, it has a market value – not less than that market value; or otherwise;
 - (b) the best price that is reasonably obtainable, having regard to the circumstances existing when the property is sold.
17. The Receiver must report to ASIC on any matter which may be irregular and which could cause ASIC to look into the conduct of anyone involved with the company's management or control.

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18. The Receiver is usually paid from the money collected by selling the company's assets but with an indemnity from the appointing secured creditor. The charge documents should authorise and specify the basis of the Receiver's remuneration. The basis should follow the IPAA Statement of Best Practice Remuneration.
19. A Secured Creditor holds a charge over a part or all of the company's assets. The rights of the Secured Creditor are set out in a document called a Mortgage Debenture document or Registered Company Charge. One right is the power to appoint a Receiver when the company fails to meet its obligations under the debenture or charge. This right exists even if the company is in liquidation.
20. Unsecured Creditors have no legal right to obtain payment from a Receiver other than for goods or services ordered by authority of the Receiver. Unsecured Creditors should contact the Liquidator, if appointed.

If Unsecured Creditors are not paid, they may apply to the Court to have the company liquidated. If a Liquidator is appointed the Liquidator is required to review the actions of the Receiver and determine whether there have been any undue preference (unfair) payments to any other unsecured Creditors.

21. Where a company in receivership is also in liquidation, Unsecured Creditors have a number of rights. These include the right to:
 - (a) Share in any available funds after priority payments and Secured Creditors have been paid;
 - (b) Choose the Liquidator unless one is appointed by the Court;
 - (c) Attend and vote at meetings of Creditors, convened by the Liquidator, on various matters including the fixing of the Liquidator's remuneration;
 - (d) Participate in the appointment and activity of a Creditors' Committee of Inspection, if formed by the Creditors;
 - (e) Receive information about the liquidation of the company including the sale of its assets and the way in which the proceeds are distributed. Creditors may also obtain a copy of the Receiver's or Liquidator's six monthly statement of receipts and payments from any ASIC Business Centre.
22. In limited circumstances, and only in liquidation, a Creditor may sue a director for the company's losses if the company was trading while unable to pay its debts on time.
23. The Court will decide on matters referred to it by Creditors, ASIC or other parties, and make any orders it thinks fit. Such matters include an application:
 - (a) To have questions decided or powers exercised by a Receiver;
 - (b) To hear an appeal from a person who has a complaint about any act, omission or decision of a Receiver.

Creditors should attempt to resolve such matters with the Receiver concerned and only go to Court if this fails.

Liquidation

24. A company is in liquidation when a registered liquidator is appointed to conduct the winding-up of a company and the liquidation of its assets. A liquidator is generally appointed on the grounds that the company is insolvent and there is no better way for creditors to maximise their return than from liquidating the assets.
25. A liquidator can either be appointed by the court or a company can voluntarily place itself in liquidation or it can end up in liquidation after a vote of creditors. In the latter case it generally occurs because a viable arrangement is not possible during the course of a voluntary

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administration.

26. One of the major tasks of a liquidator is to admit claims by creditors and then pay them according to priorities set out in the law.
27. If a company is placed in liquidation, the duty of the liquidator is to kill the company by selling the assets, distributing them to creditors and dissolving the company.
28. In liquidation, no person can perform or exercise any function or power as an officer of the company other than with the liquidator's written approval, although this does not technically remove the directors from office. However, they are stripped of all their powers.
29. A company can also be in provisional liquidation, a sort of half-way house status, while enquires are made about the financial situation of the company pending liquidation, some other form of external administration or returning the company to the control of the directors.
30. 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.
31. In a Court liquidation, the amount of fees is approved by:
 - (a) agreement with a committee of inspection (if there is one);
 - (b) a resolution passed at a creditors' meeting, or
 - (c) the court.
32. The liquidator must try to get approval by each of these methods, in turn.
33. In a creditors' voluntary liquidation, a committee of inspection or creditors may approve the fees.
34. 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.
35. The court has the power to review the amount of fees approved.
36. 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.
37. 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.
38. 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.
39. 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.
40. 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.
41. 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.

Priority of payments

42. If there are funds left over after payment of the costs of the liquidation and payments to other priority creditors (eg a secured creditors), the liquidator will pay these to unsecured creditors as a dividend. Generally, the order in which funds are distributed is:
 - (a) costs and expenses of the liquidation, including liquidators' fees and expenses;
 - (b) outstanding employee wages and superannuation contributions and superannuation guarantee charges;
 - (c) outstanding employee leave of absence (including annual leave, sick leave—where applicable—and long service leave);
 - (d) employee retrenchment pay; and
 - (e) unsecured creditors.
43. 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).
44. Determining the actual priority ranking is a difficult issue and it is beyond the scope of this overview to definitely state all rules which apply.

Proving a debt

45. Before any dividend is paid to a creditor for the debt or claim, the creditor or contingent creditor will need to give the liquidator sufficient information to prove the debt.
46. The liquidator will notify each creditor 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.
47. 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 with the notice.
48. Creditors 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.
49. If a creditor is a company, the proof of debt form must be signed by a person authorised by the company to do so.
50. 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 the claim and advise if any further information is needed.
51. The liquidator must notify a creditor within seven days if they reject the claim. If the creditor is dissatisfied with the decision, a first step should be to promptly contact the liquidator to see the matter can be resolved.
52. If you cannot resolve the matter with the liquidator, a creditor may appeal to the court. The liquidator will notify of this time in the notice of rejection. It must be at least 14 days after the creditor receives the notice. The court has the power to extend the time to appeal. If the creditor does not appeal within this time, the liquidator's decision is final.

Employee entitlements

53. A person is likely to be classified as an employee if they are:
 - (a) engaged by a company under an award, Certified Agreement, Australian Workplace Agreement, or a contract of employment, and
 - (b) paid a salary, wages or commission.
54. Contractors are not employees. They are ordinary unsecured creditors of the company.
55. An employee who is owed money for unpaid wages, superannuation, annual leave, sick leave, long service leave, retrenchment pay or other benefits, is a creditor of the company and may be entitled to some or all of what is owed in priority to the company's other creditors.
56. If the voluntary administrator continues to trade the business, they must pay out of the assets available to them ongoing wages for services provided and other employee entitlements that arise after the date of their appointment. These payments are treated as an expense of the voluntary administration.
57. The appointment of a voluntary administrator does not automatically terminate the employment of the company's employees. As a result, unless the voluntary administrator adopts the employment contracts or enters into new contracts of employment with employees, they are not personally liable for any employee entitlements that arise during voluntary administration.
58. As voluntary administration is an interim form of external administration, employee entitlements that arose prior to voluntary administration are not usually paid during voluntary administration.
59. How and when these employee entitlements are paid depends on the option passed at the creditors' meeting (i.e. company returned to directors, a deed of company arrangement, or liquidation).
60. Priority employee entitlements are grouped into classes and paid in the following order:
 - (a) outstanding wages and superannuation;
 - (b) outstanding leave of absence (including annual leave and sick leave, where applicable, and long service leave), and
 - (c) retrenchment pay.
61. If a deed of company arrangement proposes to vary the priority for employee entitlements, the voluntary administrator must call a meeting of eligible employees giving at least five business days notice of the meeting. They must give to eligible employees at the same time as the notice of meeting a statement setting out:
 - (a) their opinion about whether the proposed variation would result in the same or better outcome for employees than if the company went into liquidation;
 - (b) their reasons for this opinion, and
 - (c) any other information to help them make an informed decision about varying the priority.
62. Before each employee makes a decision on how to vote at the meeting of eligible employee creditors or the creditors' meeting where the decision is made whether or not to accept the deed of company arrangement proposal, they need to understand how the deed will affect the priority of payment of their outstanding entitlements.

The General Employee Entitlements and Redundancy Scheme (GEERS)

63. GEERS is a basic payment scheme designed to assist employees whose employment has been terminated due to the liquidation or bankruptcy of their employer and who are owed certain employee entitlements.

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64. A person is not eligible for GEERS assistance if the former employer is a company in voluntary administration or subject to a deed of company arrangement until and unless the company goes into liquidation.
65. If the company was subject to a deed of company arrangement in the 12 months before the liquidation and:
- (a) the deed had a different priority for payment of outstanding claims, including employee entitlements to that in a liquidation; and/or
 - (b) the deed did not provide for the distribution of all of the company's available funds and assets;

this will affect the employee's ability to make a claim under GEERS.

The employee should seek independent legal advice on whether the terms of a proposed deed will affect their ability to make a claim under GEERS if the company subsequently goes into liquidation.

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