

CROUCH AMIRBEAGGI GUIDEBOOK – VOLUNTARY ADMINISTRATIONS

OBJECTIVES

A company may avoid liquidation by entering into voluntary administration. The procedure is established and governed by the *Corporations Act 2001*. The Act provides a means of appointing an independent person, known as an administrator (or voluntary administrator) to take control of the affairs and management of a company that is in financial distress.

The administrator's objective is to manage the business, property and affairs of an insolvent company in a way that:

- maximises the chances of the company, or as much as possible of its business to continue in existence; or
- if the business cannot be saved, realise a better return to the company's creditors than would result from an immediate liquidation.

The administration period is typically only 25 business days.

Summary of Process

1st Business Day: Appointment of administrator

- The administrator takes control of company.
- Directors' powers cease and liability for insolvent trading ends.
- Moratorium on creditors' claims imposed.

8th Business Day: 1st meeting of creditors

- Creditors confirm appointment of incumbent administrator or replace the incumbent administrator with another.

18th Business Day: Report by administrator issued

- Disclosure of investigations and viability of rescue plan, if proposed.

25th Business Day: 2nd meeting of creditors

- Creditors determine company's future.

INITIATING A VOLUNTARY ADMINISTRATION

A voluntary administration is easy to initiate. A company may, in writing, appoint an administrator if the board has (at a validly convened board meeting) resolved the following:

- The company is insolvent or is likely to become insolvent at some future time;
 - An administrator of the company should be appointed.
- Court orders are not required.

A voluntary administration may also be initiated by a secured creditor or liquidator.

CONSEQUENCES OF APPOINTMENT

Control of the Company

While the company is under administration, the administrator assumes sole responsibility for the company's operations. Directors have no authority to deal with any of the assets or perform any management function without the express written consent from the administrator.

The administrator has the power to:

- control the company's business, property and affairs;
- terminate or dispose of all or part of the business;
- perform any function the company or any of its officers could perform.

The directors (defined as part of a wider definition known as an officer) are not removed from office; instead their powers are suspended, pending the outcome of the process (s.437C).

Moratorium on Creditor Claims

A company's assets are protected by a general moratorium on creditor's recovery actions.

During the administration period:

- proceedings in court against a company, or in relation to any of its property, cannot commence or proceed unless the administrator consents, or the court grants leave;
- a company cannot be wound up voluntarily;
- the court is required to adjourn a winding up application unless it is satisfied that it is in the interests of the company's creditors to appoint a liquidator;
- the owner or lessor of property used, occupied by, or in the possession of the company, cannot enter into possession of the property unless the administrator or court consents (subject to exceptions);
- a sheriff or court officer can not take action to sell the company's property that may be subject to a process of execution.

The administrator is not liable in damages for refusal to give approval or consent to creditors detailed above.

Retention of Title and Consignment Stock

Notwithstanding the moratorium on recovery actions, any creditor who claims to have supplied the company goods on consignment or subject to a retention of title clause will normally be requested to notify the administrator of the particulars of their claim by telephone and then confirm it by facsimile.

Creditors will generally be requested to arrange for a representative of their business to identify stock they believe to be subject to their claim and forward the following information to the administrator's office:

- Copies of all outstanding invoices and statements of liability;
- A copy of their retention of title (or consignment) clause.

Exceptions to Moratorium

The exceptions to the general moratorium on creditor recovery actions are detailed below:

- Following notice of appointment of the administrator, a secured creditor, who has a charge over the whole or substantially the whole of the property of a company, may appoint a receiver (a controller). The receiver's powers supersede those of the voluntary administrator;

- Where a secured creditor, owner or lessor has taken steps to enforce a charge or their rights prior to the appointment of the administrator, they may take possession or otherwise enforce their rights provided by the charge;
- The secured creditor, or their receiver, may enforce a charge on perishable property.

The administrator may apply to court for an order that the secured creditor, owner or lessor not exercise their powers as detailed above. Such orders will normally only be granted where the secured creditors, owners or lessors position are preserved under a rescue plan proposed by the administrator.

Personal Guarantees

During the administration period, a guarantee of company debts cannot be enforced against:

- A director
- A spouse, de-facto or relative of a director.

At the end of the administration period (normally 28 days) a guarantor will be permitted to pursue any (personal) guarantees.

A personal guarantee subject to a deed of company arrangement will not, generally, be released by operation of a deed of company arrangement.

However, if a creditor holding a guarantee votes for a deed of company arrangement that specifically alters the guarantor's rights, the guarantor will be obligated to comply with that variation.

Litigation against Directors by Liquidator

If a deed of company arrangement is executed and its requirements complied with, the company will avoid liquidation. Without a liquidator the following actions are not permissible:

- Insolvent trading against directors and holding companies
- Uncommercial transaction
- Unfair preference
- Indemnity to ATO by directors if ATO repays a preference to a liquidator

Personal Affairs of Directors

It should be noted that the administrator's role is not to advise directors in respect of their financial positions, obligations and duties to the company. In particular, some directors may be indebted to the company or concerned about prior trading and transactions of the company. I suggest that the directors seek their own legal or accounting advice in respect of any personal issues of any nature whatsoever that may relate to the company.

The directors should take special note of the fact that the duty of the administrator is to the creditors of the company at large, and acceptance of an invitation to be appointed administrator should not be construed as containing any obligation to act in director's interests in any matter relating to the proposed administration.

Supply of Goods and Services

When performing a function, or exercising a power on behalf of a company, the administrator is taken to be acting as the company's agent.

An administrator is also an officer of the company.

To protect suppliers, the administrator is personally liable for debts incurred in the performance of their functions and powers for:

- Services rendered;
- Goods purchased; and
- Property hired, leased, used or occupied.

The mere occupation or possession of property does not give rise to a personal liability. The administrator must use the property or assert a right against the owner or lessor. Additionally, the administrator is permitted 7 days free use, occupation or possession of property that is owned or leased from a third party.

Creditors should not construe adoption of a contract if payment is made for current usage of goods or services.

If a receiver is appointed, the administrator will cease to be liable for the use, possession or occupation of property.

Where an administration precedes the company's liquidation, the administrator's expenses are also given priority of repayment. In the event that a deed of company arrangement is implemented, the administrator's costs will normally be paid as a priority.

Given the onerous responsibilities imposed, the administrator will typically only purchase goods and services upon written orders originating from the administrator's office. Creditors will normally be requested to close off their accounts or ledgers as at the date of the administrator's appointment and set up a new account for the administrator.

Set-Off

Creditors cannot set-off any existing claims or debts of the company against new claims or debts that may arise during the period of administration.

Determination of Company's Future

There are three options for the company's future:

1. Entry into a rescue plan or reconstruction known as a deed of company arrangement;
2. Liquidation; or
3. Return control of the company to the directors.

Creditors, by resolution, will determine the company's future. The vote will normally be held at the second meeting of creditors known as the proposal meeting.

Report to Creditors

To ensure creditors make an informed decision regarding the future of the company, the administrator must compile a report to creditors containing the following:

- Disclosure of company's business, property, affairs and financial circumstances;
- The administrator's opinion and reasons why it would be in the creditors' interests for:
 - i) the company to execute a deed of company arrangement;
 - ii) the administration to end; or
 - iii) the company to be wound up.
- If a deed of company arrangement is proposed, a statement setting out details of the proposed deed.

The administrator's report must state if there are any transactions that appear to be voidable transactions, in respect of which money, property or other benefits may be recoverable by a liquidator.

Investigations by administrator

In addition to the investigations required to discharge the reporting obligations to creditors, the administrator must compile a report for ASIC where, in the administrator's opinion the following has occurred:

- A past or present officer (or a member) of the company may have been guilty of an offence in relation to the company; or
- A person who has taken part in the formation, promotion, administration, management or winding up of the company:
 - i) may have misapplied or retained, or may have become liable or accountable for, money or property (in Australia or elsewhere) of the company; or
 - ii) may have been guilty of negligence, default, breach of duty, or breach of trust in relation to the company.

MEETINGS OF CREDITORS

The First Meeting of Creditors

The first meeting of creditors must be held within five business days after the administrator's appointment. Due to the time constraints imposed by the Act, creditors will normally receive a written notice only two days before this meeting.

The first meeting of creditors will endeavour to explain to creditors:

- The company's business, property, affairs and financial circumstances;
- Preliminary indications regarding the future prospects of the company including the potential for the company to be reconstructed via a deed of company arrangement.
- Potential returns to the creditors, if any.

At the first meeting, the creditors may remove the incumbent administrator and appoint another administrator.

Creditors may choose to form a committee of creditors to consult with the administrator about matters relating to the administration and to receive and consider reports by the administrator. A committee cannot give directions to the administrator (except to call a meeting of the committee).

The Proposal or Second Meeting of Creditors

The second meeting of creditors will normally be held 28 days after the administrator's appointment. This meeting will normally determine the company's future.

Adjournments are permitted for a period of up to 60 days without Court consent.

Directors will normally be requested to attend both meetings of creditors.

Information for Creditors for Meetings

Creditors will normally receive the following information:

- Notice of meeting and agenda;
- Appointment of proxy (Form 532) for use only at a specific meeting of creditors;
- Proof of debt (Form 535) valid for all meetings;
- Creditors may be required to complete and return the proof of debt (Form 535) and appointment of proxy (Form 532) at least 24 hours prior to a meeting of creditors in order to be eligible to vote and participate at the meeting;
- For the first meeting, creditors will normally be provided with:
 - i) general information regarding voluntary administrations from the Insolvency Practitioners Association of Australia (IPAA);
 - ii) a list of creditors.
- For the second meeting, creditors will normally be provided with:-
 - i) report detailing investigations, options for company's future and recommendations;
 - ii) details of proposed remuneration of administrator for consideration by creditors.

Voting at Meetings

Only creditors (or their proxies) are eligible to vote at the meeting of creditors.

The administrator, as chairman, will adjudicate on the eligibility and quantum of creditors claims for voting purposes.

All resolutions will be decided on the voices. The chairman will declare the majority's intentions. Unlike bankruptcy and liquidation scenarios, a secured creditor is entitled to vote in respect of the value of their security without surrendering or deducting the value of their security.

A poll may be demanded before, or on, the declaration of the result of the voices.

Where a poll is called, a resolution will be carried if:

- more than 50% *in number* of the creditors who vote, do vote in favour of a resolution; and
- more than 50% *in value* of the creditors who vote, do vote in favour of the resolution.

Deadlocks may be resolved by the administrator as chairman.

The incumbent administrator may exercise any general proxies to vote against a resolution to remove the administrator from office and appoint a replacement administrator.

An administrator may also use special proxies to vote for a deed of company arrangement unless another administrator has consented to act and chosen to compete with the existing administrator for the right to act as deed administrator.

DEED OF COMPANY ARRANGEMENT

A rescue plan or reconstruction of a company may be implemented by a formal agreement with creditors known as a deed of company arrangement.

Responsibility for Proposal

Directors and other interested parties are responsible for formulating a proposal for creditors to consider. The administrator is not required to design or create the proposal for a deed of company arrangement. However, an administrator will normally assist directors to formulate any proposal, if requested.

Contents of Deed

The content of a deed of company arrangement is contingent upon the company's circumstances. A deed will typically be a binding agreement between a company and its creditors, which provides for new terms for the repayment of existing debts. The new terms may include any of the following:

- A moratorium of payments to creditors for a defined period;
- Company continues to trade;
- Compromise, release or reduction from a company's current unsecured debts. Normally this is in consideration of an undertaking by the company to repay a new reduced debt to its creditors by a lump sum or by periodic payments to a fund controlled by a deed administrator;
- Merger, sale or closure of existing operations;
- Ability to use tax losses maintained;
- Takeover of operations of new joint venture;
- Injection of new management, capital or other expertise;
- Reorganisation of loans and shareholdings;
- Debt forgiveness by stakeholders.

The deed of company arrangement must include:

- the particulars of property of the company that is to be available to pay creditors' claims;
- the nature and duration of any moratorium period;
- the extent to which the company is to be released from its debts;
- the conditions for operation and termination of the deed;
- the order creditors will be paid;
- a date for claims to be lodged under the deed.

Typically, a deed of company arrangement would include a binding agreement on all creditors (except secured creditors) to accept x cents in the dollar in full and final settlement of all creditors claims. (The average repayment approximates 28 cents in the dollar.)

The timing of the creditor payments of x cents in the dollar will be determined by the deed. Typically creditors would be paid 12 to 24 months after the date of appointment of the administrator. This provides time for the company to contribute monthly instalments to an administration fund, which is controlled by the deed administrator.

Execution of Deed of Company Arrangement

If the proposal is accepted by creditors, a deed of company arrangement will be drafted in accordance with the terms detailed in the proposal. To be effective, the deed must be executed by the company within 21 days of the proposal meeting. The administrator of the deed must execute the instrument before or as soon as practicable after, the company executes it.

When executed by both the company and the deed's administrator, the proposal becomes a deed of company arrangement.

Effect of Deed of Company Arrangement

Release from Debts

A deed of company arrangement releases the company from a debt only in so far as:

- The deed provides for the release; and
- The creditor concerned is bound by the deed.

Binding Agreement with Creditors

A deed of company arrangement binds all creditors of the company, so far as it concerns claims arising on the date of appointment of the administrator (unless the deed prescribes an alternative date).

Creditors Not Bound by Deed

A deed of company arrangement does not:

- bind or prevent a secured creditor from realising or otherwise dealing with their security;
- affect a right that an owner or lessor of property has in relation property;

except so far as the secured creditor, owner or lessor voted in favour of the alteration of their rights as prescribed by the deed.

Taxation debts

From 1 July 1993 the priority repayment of taxation liabilities was revoked. Subject to rare exceptions, outstanding tax debts including penalties (excluding court penalties) are now treated just like any other trade creditor.

If a deed of company arrangement is accepted by the prescribed majority of creditors, the Australian Taxation Office (ATO) must accept the terms prescribed by the deed (i.e. x cents in the dollar in full and final settlement of outstanding taxation obligations).

It is for this reason that a deed of company arrangement is sometimes looked upon by directors as a remedy to the claims by the ATO, and on occasion resisted by the ATO.

Directors should be advised the Income Tax Assessment Act has provision to make a director personally liable for failure to remit tax to the ATO. A precondition of this personal liability is the service of notice stating the ATO's intention and detailing the options for the director to avoid the imposition of personal liability.

The Corporations Act also provides that a director may be personally liable to indemnify the ATO if it is compelled to repay a preference payment to a liquidator.

Control of the Company

Typically the powers of the administrator to control the company's business, property and affairs will revert back to the directors upon entering into the deed of company arrangement.

A deed may provide that directors have a limited authority to deal with any of the assets, perform certain management functions, or the deed administrator be provided with regular management accounts.

The directors must ensure that a company under administration discloses on every public document, and the expression "(administrator appointed)" is placed after the company's name on every negotiable instrument.

Secured Creditors

The return available to the secured creditors will be contingent upon the following:

- The potential sale price of the business or assets.
- The potential return available from a deed of company arrangement if proposed and implemented.
- The priority, validity and assets subject to each of the secured creditors charges.

These contingencies will normally be determined in 2-3 weeks. The administrator's report to creditors should contain sufficient information to enable the secured creditors to determine their position within 3 weeks. However, all secured creditors should make their own enquiries and take independent legal advice regarding their own circumstances.

Options for Secured Creditors

The possible courses of action are detailed below:

- i) Where a secured creditor is adequately protected they may elect not to participate in the voluntary administration.
- ii) If the proceeds of realisation of the assets subject to a charge are inadequate to discharge the funds due to a secured creditor, the secured creditor will have unsecured claim to the extent of the inadequacy. Accordingly, the secured creditor may participate in the administration process as both partly secured and unsecured creditor.
- iii) A secured creditor may realise the secured property, either personally or via an agent. The secured creditor would then become a "mortgagee in possession". A secured creditor may wish to avoid becoming a mortgagee in possession because of the potential personal liabilities that result from dealing with the property. In 1993 the taxation advantages of a mortgagee in possession were eliminated when the extended definition of a controller imposed duties and liabilities on mortgagees in possession via Part 5.2 of the Corporations Act 2001.

- iv) A secured creditor may appoint a receiver and manager to realise the assets subject to their charge. This process is likely to involve a duplication of costs that are likely to be incurred by the administrator. The administrator will be entitled to a lien over the assets held prior to the appointment of a receiver and manager.

Litigation against Directors by Liquidator

If a deed of company arrangement is executed and its requirements complied with, the company will avoid liquidation. Without a liquidator the following actions are not permissible:

- Insolvent trading against directors and holding companies
- Uncommercial transaction
- Unfair preference
- Indemnity to ATO by directors if ATO repays a preference to a liquidator

Variation of Deed of Company Arrangement

A deed of company arrangement may, after execution, be varied by creditors at a meeting of creditors called for that purpose.

TERMINATION OF VOLUNTARY ADMINISTRATION

The voluntary administration will normally terminate when:

- A deed of company arrangement is executed;
- The creditors resolve that the administration should end;
- The creditors resolve to liquidate the company.

Proceeding to Liquidation

A company subject to a voluntary administration can be placed into liquidation in the following circumstances:

- Creditors resolve to wind up the company at the 2nd meeting of creditors;
- The company fails to execute a deed of company arrangement within 21 days of the proposal meeting; or
- Creditors resolve to terminate an existing deed of company arrangement at a meeting convened for that purpose.

If a company goes into liquidation after an administration or deed of company arrangement, the liquidation is deemed to have commenced from the date the company first entered administration.

The recovery actions available to a liquidator as at the date of the appointment of the administrator are, therefore, preserved and remain viable. However, the liquidator will need to be mindful that a liquidator must make an application for a recovery action within three years of the date of appointment of the administrator.

Remuneration

Section 499(3) of the Corporations Act 2001, prescribes that a liquidator's remuneration is set and approved by creditors as a whole or via a elected group of creditors known as a committee of inspection. Remuneration is subject to review by an appropriate court.