DIFFERENT FORMS OF ADMINISTRATION IN CORPORATE INSOLVENCY

BY MARK DOBLE, PARTNER

7 MAY 2013

EAKIN
McCAFFERY
COX
LAWYERS

OVERVIEW

1. In this paper I address the three most common types of administration of insolvent corporations.
2. The three types of administrations with which I intend to deal are:
   (1) Liquidation;
   (2) Voluntary administration with a view to executing a deed of company arrangement; and
   (3) Receiverships.
3. I should point out that in the context of liquidation, or winding up, there are two types. One is voluntary liquidation and the other is official liquidation namely a winding up by way of Court order. Ultimately, little turns on whether a liquidation is entered into voluntarily or imposed by the Court.
4. At some stage, we can discuss the various pitfalls associated with each type of administration.

LIQUIDATION OR WINDING UP

5. I will deal firstly with Court windings up, namely Official Liquidation.
6. An Official Liquidation is generally brought about on the application of a particular creditor who has in most cases first served a creditor's statutory demand for payment of debt pursuant to section 459E of the *Corporations Act*.
7. With or without a judgment, a creditor who asserts that there is no dispute as to a debt it is owed may serve a statutory demand pursuant to section 459E of the *Corporations Act.* The corporation upon which the demand is served has 21 days in which to either:
   (1) Pay the debt; or
   (2) Make an application to the Court to set aside the statutory demand on the basis that the debt is disputed.
8. If the debtor company does not take one of these courses there is a statutory presumption of insolvency which triggers the creditor's right to commence proceedings in either the Supreme Court of any State or Territory or the Federal Court for the winding up of the company.
9. There are very limited avenues of defence to such an application.
10. Assuming no defences are raised, the Court will make a fairly routine order winding up the debtor company and appointing a liquidator.
11. The liquidator's role is to wind up the affairs of the company namely, to bring in and dispose of its assets and thereafter to distribute the proceeds according to the priority afforded by section 556 of the *Corporations Act*.
12. That priority is essentially:
   (1) The legal costs of the creditor who brought the winding up application;

(2) The costs and expenses of the liquidator incurred in relation to the winding up itself;

(3) Employees entitlements; and

(4) Pro rata amongst unsecured creditors of the company.

13. Sadly, in most windings up, there is rarely a distribution after the liquidator's remuneration and expenses. I should point out however that a liquidator is performing a statutory function pursuant to the *Corporations Act* and must take each job as it comes. What I'm getting at is, in at least half, probably closer to three quarters of Court appointed windings up, there are no assets at all and the liquidator has foisted upon him or herself the obligation to conduct the winding up notwithstanding that he or she will not be paid.

14. Once a liquidator has been appointed, the functions of the company's offices are suspended. Only the liquidator can deal with the company's assets and affairs.

15. Once the liquidator's role has been performed, the company's affairs have been wound up and its assets realised and distributed, the liquidator applies to the Australian Securities and Investments Commission to have the company deregistered. At that time the company ceases to exist.

16. From an unsecured creditor's point of view, there are two salient matters arising out of the appointment of a liquidator.

17. The first is the liquidator's right to disclaim onerous property. What this means is if there is property, such as a lease or a contract, which is "onerous" upon the company (that is to say costs money), the liquidator has a right to disclaim that property and simply walk away from it. The other party to any such transaction has no rights of recourse back against the liquidator.

18. The second issue which may be of relevance is a liquidator's right to "claw back" antecedent transactions. There are a number of antecedent transactions voidable at the insistence of a liquidator. They include:

(1) Unfair preference payments;

(2) Uncommercial transactions;

(3) Unfair director related transactions; and

(4) Voluntary alienation of property with an intention to defraud creditors.

19. For unsecured creditors who were in a trading relationship with the company, the most likely antecedent transaction to be of relevance is an unfair preference payment.

20. An unfair preference is essentially:

(1) A transaction between the company and a creditor;

(2) Entered into at a time when the company is insolvent (within 6 months prior to the commencement of the winding up); and

(3) Which results in the creditor receiving more than it would receive if the transaction was set aside and the creditor were to prove in the winding up.

21. An example might be as follows:
    (1) Company A owes Bill $50.00 and Betty $50.00;
    (2) Company A only has $50.00;
    (3) Company A likes Betty more than it likes Bill and pays the entirety of its savings namely $50.00 to Betty and Bill gets nothing.
    (4) In an ideal world, the liquidator would demand that Betty repay him or her $50.00 and, having accounted to him or herself for his fees, would divide the net proceeds equally between Bill and Betty such that neither has been preferred.
22. There are defences to a claim by a liquidator for an unfair preference, commonly known as the "good faith" defence. To make out such a defence, a creditor would have to be able to prove that he or she was unaware that the debtor company was unable to pay its debts as and when they fell due and such had no knowledge that he or she was being preferred.

VOLUNTARY WINDING UP

23. There are two types of voluntary windings up.
24. The first type of voluntary liquidation is a creditors' voluntary winding up in which case the company appoints a liquidator prior to any creditor making a Court application for its winding up.
25. A creditors' voluntary winding up may also occur as part of the voluntary administration process which I will discuss shortly.
26. The second is known as a members' voluntary winding up. In a members' voluntary winding up, the corporation is solvent and the liquidator's role is simply to bring in the assets and distribute them amongst the shareholders according to the shareholders' entitlements. If, upon the appointment of a liquidator in a members' voluntary winding up, it becomes apparent that the company is in fact insolvent, the liquidator must call a meeting of the company's creditors and the liquidation will morph into a creditors' voluntary winding up.
27. The function of a liquidator in either an official liquidation or voluntary liquidation is the same and the consequences for unsecured creditors are the same.

OTHER TYPES OF COURT APPOINTMENT

28. There are two other types of Court appointed liquidators.
29. The first is under the so called "just and equitable" ground, usually arising out of a shareholders' dispute.
30. The second is a provisional liquidation. A provisional liquidator is appointed to maintain the status quo while the over-riding dispute is sorted out. A provisional liquidator will often continue to trade the company's business.

VOLUNTARY ADMINISTRATION

Part 5.3A of the Corporations Act

31. Part 5.3A of the *Corporations Act* was enacted with the express object of providing for the business, property and affairs of an insolvent company to be administered in a way that:
    (a) maximises the chances of the Company, or as much as possible of its business, continuing in existence; or
    (b) if it is not possible for the Company or its business to continue in existence - results in a better return for the Company's creditors and members than would result from an immediate winding up of the Company.
32. Part 5.3A deals with voluntary administration of a Company.
33. A Company, by resolution of its Board may appoint an administrator if the Board thinks it is or will become insolvent (section 436A). A secured creditor or a liquidator can also appoint a voluntary administrator.
34. Upon the appointment of the administrator, the administrator must hold a meeting of creditors within 5 business days after his or her appointment (section 436E).
35. The purpose of the section 436E meeting is to advise creditors in relation to the appointment of the administrator and the particulars of the conduct of the administration.
36. Upon the appointment of the administrator, creditors' rights to take any action against the Company are stayed. With certain, limited exceptions, a secured creditor or the owner of property occupied or leased by the Company cannot take action.
37. Pursuant to section 443A, an administrator is liable for debts he or she incurs in the performance or exercise, or purported performance or exercise of any of his or her functions and powers as administrators for:
    (a) services rendered; or
    (b) goods bought; or
    (c) property hired, leased, used or occupied by the Company.

This would include amounts due under any Agreement (including a franchise agreement) moving forward.

38. Pursuant to section 439A, the administrator of a Company must convene a second meeting of the Company's creditors within 21 days from the day on which the administration begins for the purpose of informing creditors of the circumstances of the Company and making a recommendation as to the Company's future.
39. At that meeting, creditors may elect to adjourn the meeting for up to a further 60 days.
40. In reporting to creditors, the administrator must make a recommendation as to the future of the Company. The 3 options are:
    (a) the Company be wound up;
    (b) the Company enter into a Deed of Company Arrangement; or
    (c) the administration end.
41. Given that in order to appoint a voluntary administrator, a Company must generally be insolvent, it is quite unusual for an administrator to recommend or for creditors to resolve that the administration simply end.
42. If the Company is wound up, the administrator becomes the liquidator and the Company proceeds by way of creditors' voluntary administration.
43. In the event that the Deed of Company Arrangement is proposed by directors or shareholders (or another interested party) the Company will remain in existence with debts being compromised or paid in full (depending upon the Deed proposal). Generally, control of the Company returns to its directors under a Deed of Company Arrangement.
44. The administrator (of the Deed) generally simply administers the Deed fund (being the fund of money paid under the Deed of Company Arrangement for the benefit of creditors). Once the Deed fund has been paid out in accordance with the terms of the Deed, the Deed of Company Arrangement ends and the Company continues on. Debts due by the Company to creditors are generally extinguished once the Deed has been fully effectuated.
45. The Supreme and Federal Courts have power to intervene in relation to the conduct of the administration and any Deed of Company Arrangement. Creditors have standing to make an application to either Court.

RECEIVERSHIPS

46. A receiver or receiver and manager is generally appointed by a secured creditor pursuant to what used to be called a charge and what is now known, under the Personal Properties and Securities Legislation as a security interest.
47. It is probably easier to refer to security interests by their previous names.
48. A non-circulating security interest used to be called a fixed charge. A fixed charge is a charge, or mortgage, over a specific item, for example a truck.
49. A circulating security interest used to be known as a floating charge. It is so named because it "floats" over the assets of a company as they exist from time to time until the charge is crystallised, generally by reason of a default by the debtor company.
50. Most charges make provision for the appointment by the secured creditor of a receiver.
51. Whilst a receiver bears obligations to all creditors, he or she generally behaves differently to a liquidator. A receiver's first priority is to pay the secured creditor and once the secured creditor has been paid, the receiver will retire.
52. It is important to note that it is far from uncommon that when a company is placed into liquidation or appoints a voluntary administrator, that a secured creditor will appoint a receiver "over the top" to protect the interest of the secured creditor.

DEALING WITH INSOLVENCY ADMINISTRATORS

53. Many unsecured creditors will have a serious vested interest in the event of the insolvency of a company with whom they have been in a trading relationship or perhaps a franchise relationship.
54. From the outset, it is important to attempt, as best as possible, to establish some sort of rapport with the insolvency administrator to work in everyone's best interests to preserve as much as possible of the insolvent company's business as is possible either with an aim to rehabilitating the insolvent company and continuing to trade or alternatively to ensure that its business is saleable and also to increase the return to creditors of the insolvent company.

PPSA

55. I have discussed previously the new terms of art under the Personal Properties Security Legislation.
56. It cannot be denied that PPSA had teething problems particularly in terms of the additional searches necessary to ascertain who had security over what.

57. Part of the problem is that people were registering as securities, documents which did and do not have the legal force and effect of granting a security. Unfortunately, in the 18 months or so to date since the regime came into play, that hasn't really changed.
58. From a practical perspective, you should, by reference to the description of the goods said to be secured under a search be able to identify what they are.

Mark Doble is Head of Eakin McCaffery Cox Lawyer's litigation department. He has extensive experience in corporate insolvency and bankruptcy.