The Insolvency Experts
Licensed and Low Cost Liquidation Specialists

A SIMPLIFIED GUIDE TO

CORPORATE INSOLVENCY & LIQUIDATION

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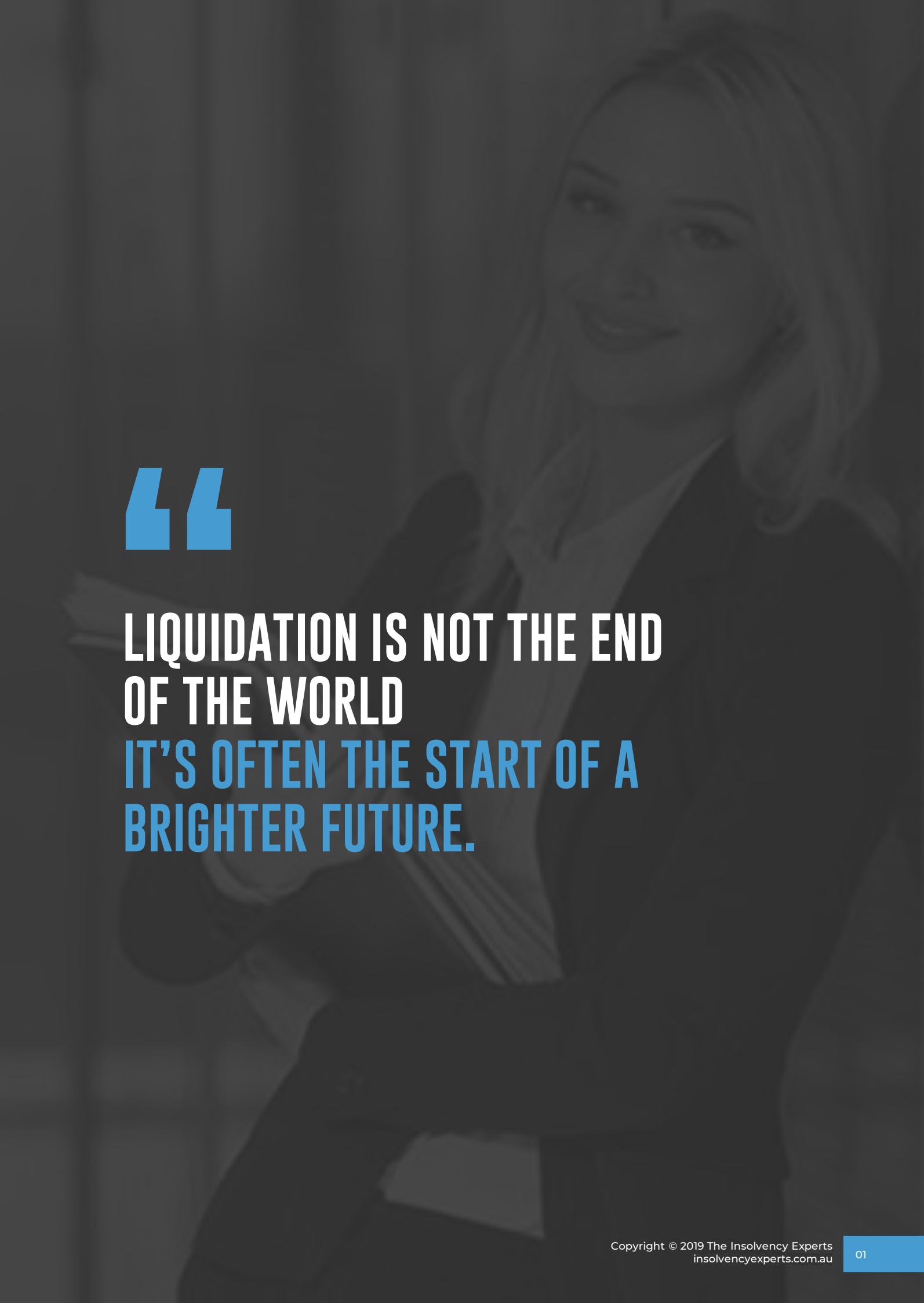

LIQUIDATION IS NOT THE END OF THE WORLD
IT'S OFTEN THE START OF A BRIGHTER FUTURE.

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DISCLAIMER

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FREE 24 HOUR INSOLVENCY HOTLINE

1300 767 525

Free Telephone Advice

No Time Limit On Advice

No Obligation or Cost

Everything You Need To Know About Your Specific Situation

Advice Provided To Directors

Advice Provided To Accountants & Solicitors From A Registered Liquidator To Pass Onto Their Clients

Licensed and Regulated by ASIC.

Resolve Insolvency Problems Quickly To Relieve Stress

WHO WE ARE

The Insolvency Experts are ASIC Registered Liquidators with over 30 experience in liquidating hundreds of small to medium sized companies and in advising company directors how to deal with the prospect of insolvency and liquidation.

We are passionate about helping people suffering stress caused by severe financial circumstances.

Our aim is to serve by providing expert advice, free of charge and obligation, through the only genuine 24 hour insolvency advice line where all calls are answered by a Registered Liquidator – not a salesperson or call centre.

Our advice empowers directors and/or their advisers to make a fully informed decision by providing complete, correct and unbiased information. If liquidation or similar is not appropriate, we will tell you so.

Being qualified, licensed and experienced, and with over 30 years Corporate and Personal Insolvency Experience, there is almost no situation we haven't dealt with and resolved for our clients.

In the spirit of service, we will happily share our knowledge and experience, free of charge and obligation, with anyone who is suffering some form of financial hardship.

We are the original low cost provider of liquidation and insolvency services in Australia and are available anytime to assist on 1300 767 525.

- Free, confidential and no obligation consultations.
- Free telephone consultation – 24 hours
- We will happily come to your office.
- We are always happy to meet with the client and their advisers
- We can also advise professionals who wish to advise their clients alone.
- Everything you need to know.
- Answers, Options & Solutions

LIQUIDATION

WHAT IS LIQUIDATION?

Liquidation is a process whereby a company's financial affairs are wound up and the structure itself is dissolved.

An insolvent company liquidation is one where there are insufficient funds available to pay all outstanding claims in full. This type of liquidation requires appropriate investigations to be undertaken by a Registered Liquidator who is required to explain the cause of failure and report those results, together with any offences against the law, to creditors and the ASIC.

An insolvent liquidation will ultimately result in the proper distribution of a company's assets to its creditors in accordance with the order of priorities as detailed under the Corporations Act.

Liquidation may also apply to a solvent company where its members want the company's existence to end and have it struck off from the companies register. A person winding up a solvent company does not need to be a Registered liquidator.

Either way, liquidation is the only way to fully wind up the affairs of a company and end its existence.

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WINDING UP INSOLVENT COMPANIES

An insolvent Company may be wound up in two ways.

- First, voluntarily by shareholders agreeing to select and appoint a liquidator; or
- On application to Court by any unpaid creditor owed more than $2,000. Here, the Court will usually appoint the Liquidator nominated by the creditor.

Either way, a Registered Liquidator is required to wind up an insolvent Company.

VOLUNTARY LIQUIDATION - THE SHAREHOLDERS' CHOICE

An insolvent company may be voluntarily placed into liquidation by a resolution passed by a 75% majority of the shareholders.

Where shareholders agree to appoint a liquidator, the process is known as a **Creditors Voluntary Liquidation**.

This method of liquidation is either;

- paid for by the sale of all Company assets, if any remain; or
- if no assets remain, the directors/shareholders may agree to a fixed contribution towards the cost of the liquidation process.

So, if there are assets remaining within a Company, and those assets are sufficient to cover the costs of a liquidation, directors and shareholders will not need to contribute anything to the winding up process.

However, where no assets remain, a Registered liquidator will need to have their basic fee covered and will agree to a fair and fixed director contribution towards the costs and expenses of performing the liquidation. The agreed amount will depend on a number of factors including the situation of the Company, the number of creditors and the complexity of issues expected to name but a few.

Each case is assessed individually but obviously, the more creditors and issues there are, the more professional time will be spent and a higher contribution required by the director/shareholder. It is noted that while a contribution will be fixed, such an agreement does not absolve a director from any lawful claims that may exist or be discovered through the process of liquidation.

As a guide only, an insolvent Company liquidation with a limited number of creditors and no obvious complexities may require a fixed director contribution from as little as $5,500 – $9,000.

However, as with any professional service, each matter must be individually assessed and we encourage you to call anytime on 1300 767 525 for a free quote specific to your circumstances.

OFFICIAL LIQUIDATION - THE CREDITORS' CHOICE

An insolvent company may be wound up on the petition of an unpaid creditor to the Court.

This process is paid for by the aggrieved creditor and will cost in the order of $7,000 to $9,000 in legal and court filing fees.

In this case, it is the creditor that nominates the Registered Liquidator. The Court will normally appoint the liquidator nominated. This type of liquidation is known as an Official Liquidation.

Creditors of an insolvent company may also elect to appoint a liquidator at the end of the Voluntary Administration process.

Where the members voluntarily decide to liquidate, their choice of liquidator can be removed and changed by creditors at a meeting or by application to the Court although in practice, this rarely occurs.

Members of a company cannot choose a liquidator once a wind-up application has been lodged with Court.

ARE THERE ANY BENEFITS TO LIQUIDATING?

Yes – Many if not most of our clients report that liquidation helped them in terms of:

- Immediately ending the stress of continual creditor harassment
- Diverting attention to the Liquidator's office and away from the director
- Protection from possible personal liability for insolvent trading and unpaid taxes
- Bringing to an end an unwinnable fight that often has been fought for years
- Being able to concentrate on obtaining a regular income
- Being in a position to improve health and personal relationships undone by years of stress

EMPLOYEES ALSO BENEFIT FROM LIQUIDATING

If a company has been unable to pay wages and entitlements (not including superannuation), as soon as the company enters liquidation, eligible employees will have access to the Fair Entitlements Guarantee Scheme.

Under this scheme, eligible employees can recover unpaid wages and entitlements, often within 6 weeks of the liquidation commencing.

Once employees have been paid out, the Attorney-General's Department is subrogated to the position of the employees in respect of the liquidation process. Accordingly, if a distribution occurs as a result of the winding up, payments made by the government in respect of employee entitlements will be repaid in priority to other creditors. If no distribution occurs, there is no liability for a director in respect of payments made under the scheme.

HOW DO I START A VOLUNTARY LIQUIDATION?

The first step is to call us free of charge on 1300 767 525 and obtain advice specifically tailored to your circumstances.

The Insolvency Experts provide a Free, 24 Hour, no-obligation telephone service to answer all your questions about company liquidation and insolvency generally. If liquidation is not appropriate, we will let you know the most appropriate course of action.

Whether you speak with us or another firm, always insist on speaking with a person that is registered and licensed with ASIC – preferably the Registered Liquidator themselves who will manage your company's liquidation. By doing so, the person advising you is able to be held accountable by the authorities for any advice given.

Avoid salespeople and unscrupulous, unregulated and unlicensed advisors who prey around the edges of the insolvency system, often exploiting vulnerable people in financial crisis.

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WHAT IS THE TIMING OF PLACING A COMPANY INTO VOLUNTARY LIQUIDATION?

The Insolvency Experts can have your company placed into liquidation within the day – if necessary.

We provide directors and shareholders with all documents needed to achieve a quick liquidation – and we can usually get those forms to you within an hour of our first discussion.

All we need from you are the following:

- Return of the signed forms that include Minutes of Meetings and ASIC lodgement forms
- A list of creditors names, addresses and amounts (amounts don't need to be precise but should be as good as possible)
- A list of employee entitlements, names, addresses and amounts
- A listing of any assets
- Details of any leased assets

HOW LONG DOES LIQUIDATION TAKE – START TO FINISH?

There is no set time frame to complete a liquidation. However, The Insolvency Experts provide an express service where we aim to complete a simple liquidation within 4-6 months.

Occasionally, if a matter is complex, a liquidation may take a longer than this. Factors that affect the time to complete a liquidation include:

- Legal proceedings such as the recovery of assets or debts
- Awaiting ASIC approval to complete the liquidation
- Awaiting creditors views on various claims that may exist.

WHAT POWERS DOES A LIQUIDATOR HAVE?

The liquidator's powers are set out in the Corporations Act. In addition to all the powers of a director, the liquidator has power to:

- Take control of and locate all company assets
- Conduct the business of the company
- Realise the assets of the company including its business
- Investigate the affairs of the Company
- Identify and review transactions of the company
- Undertake any legal action available to the company
- Issue reports to the creditors
- Issue report to the ASIC
- Distribute any surplus assets to the creditors and then shareholders

WHAT INVESTIGATIONS ARE PERFORMED BY THE LIQUIDATOR?

A liquidator of an insolvent company is required to investigate the affairs of the company and explain the reasons for its failure as well as when the company first became insolvent. The liquidator is also required to report to the ASIC and creditors any possible offences committed by the directors and officers.

The investigations performed will also concentrate on explaining the financial transactions of the company including any preferential payments, uncommercial or unreasonable director related transactions. Where such transactions are identified, the liquidator may attempt recovery, where possible.

WHAT ARE THE DIRECTORS REQUIRED TO DO IN A LIQUIDATION?

The directors are required to give the liquidator all the books and records and other information about a company's affairs. They are also required to provide a Report on the Company's Affairs and Property that will detail the assets and liabilities of the company at the date of liquidation. In addition, directors are required by law to provide any reasonable assistance to the liquidator when requested to do so and cooperate throughout the liquidation process. Directors that fail to comply may be prosecuted by the ASIC or examined.

In reality, apart from the above, directors are not required to provide much assistance during the winding up process. In terms of time, there is very little imposition on a director who is expected to get on with life from the moment a company is placed into liquidation.

DIRECTOR PENALTY NOTICES

WILL A DIRECTOR BE LIABLE FOR UNPAID TAX AND SUPERANNUATION?

Directors may be held personally liable for certain company tax debts.

The Australian Taxation Office may hold a director personally liable for unpaid PAYG and unpaid superannuation. Presently, directors are not held liable for unpaid GST however this is changing on 1 April 2020.

SUPERANNUATION

There have been recent changes in relation to superannuation that all directors must be aware of. In particular, superannuation obligations are due to be paid:

- When a company lodges its quarterly superannuation guarantee statement; or
- When the ATO quantifies an unreported superannuation guarantee shortfall.

Superannuation obligations are now payable on the same day the company lodges its quarterly superannuation guarantee statement with the tax office – typically one month and 28 days after the end of the quarter.

If the payment is not made, the ATO may issue a Director Penalty Notice at the end of the lodgement day as soon as no lodgement or payment has been made.

Effectively, as superannuation represents an employees funds, there is now no tolerance afforded and no way a director can avoid a personal liability for unpaid superannuation.

UNPAID PAYG & GST

The changes above only relate to unpaid superannuation. The rules regarding Director Penalty Notices and unpaid PAYG remain the same.

That is that there are two types of Penalty Notices:

01

LOCK DOWN PENALTY NOTICES

Where a director has failed to lodge BAS or IAS returns within three months of the due date for lodgement after the end of a quarter.

In this case, the penalty issued by the ATO for not reporting the debt within the 3 month limit cannot be avoided and must be paid by the Company firstly, and if that is not possible, the director personally.

02

NON-LOCK DOWN PENALTY NOTICES

Where BAS and IAS have been reported within the three month window referred to above, and the ATO wishes to attach personal liability to a director, it may issue a Director Penalty Notice – but this type can be complied with in order to avoid personal liability for a company tax debt.

Specifically, personal liability under this type of penalty notice will be avoided if, within 21 days of the date of the notice, the company:

- Pays the debt
- Is placed into voluntary administration
- Is placed into liquidation.

If any of the three options above are achieved within the time limit, the penalty will be remitted and personal liability avoided.

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WHAT HAPPENS TO LEASED ASSETS IN LIQUIDATION?

A lease, hire purchase or other finance agreement typically contains a personal guarantee. As such, Directors need to understand what is likely to happen with leased assets in a liquidation setting.

If a liquidator finds a company has assets subject to finance, he will compare:

- The value of the asset -v- its payout value.
- If the value of the asset exceeds the payout value of the finance – the item has positive equity. The Liquidator will look to sell the item and payout the finance.
- If the payout exceeds the value of the asset – it is a net liability. The Liquidator will have no interest in it and will disclaim the contract and the asset.

Where there is positive equity and the director wants to retain possession of the asset, the liquidator may sell the net equity in the contract to the director who is then required to continue servicing the finance agreement.

If the payout exceeds the value of the asset, the liquidator will disclaim any interest in the asset.

A disclaimer formally advises the financier that the company has no further interest in the item or the contract. Once the financier receives this notice, it will act in a number of ways.

Firstly, if they are not satisfied with the director because they have experienced difficulties with payments etc., the Finance Company may repossess and sell the item. If this occurs, the guarantor may be liable for collection & selling fees, penalties and interest as well as being charged for any shortfall on the facility after the item has been sold, usually by auction.

Depending on the size of any shortfall, bankruptcy or the loss or sale of the guarantors' home or other assets may follow.

Alternatively, if the guarantor is able to satisfy the finance company that the finance agreement will be honoured, the financier may be satisfied to allow the guarantor to continue in possession if they continue making payments.

If a guarantor is unable to continue servicing the finance agreement, they may consider selling the financed equipment but as the encumbrance will be noted on the title, clear title will not be able to be provided to any purchaser without the finance company expressly agreeing to a sale.

A finance company will usually give permission for the sale of a leased asset only where the guarantor provides a top up payment to ensure full payout of the finance agreement. It is only at this time the finance company will agree to removal of any listings against the assets' title.

WILL A DIRECTOR BE BANNED OR DISQUALIFIED FOR GOING INTO LIQUIDATION?

As long as a director is not bankrupt, convicted of an indictable offence or subject to a director banning order and disqualified from acting as a director, a person is entitled to be a director of another company immediately even if a company is placed into liquidation.

However, ASIC may disqualify a person from acting as a director or being involved in the management of a company, in extreme cases, for up to 20 years.

However, Banning orders for up to 5 years will usually only apply when a Director has been involved in 2 or more company failures within a 7 year period, and where those liquidations have resulted in returns to creditors of less than 50 cents in the dollar.

In determining whether a disqualification is justified, ASIC must have regard as to whether the 2 or more failed corporations were related to one another and also the persons' conduct, whether the disqualification is in the public interest and any other appropriate matters.

COURT ORDERED DISQUALIFICATION

Under **Section 206C of the Corporations Act,** on application by ASIC, the Court may disqualify a person from managing corporations for a period the Court considers appropriate if the Court is satisfied the disqualification is justified.

In determining whether the disqualification is justified, the Court will have regard to:

- A person's conduct in relation to the management of any corporation; and
- Any other matters the Court considers appropriate.

Under **Section 206D and Section 206E of the Corporations Act,** on application by ASIC, the Court may disqualify a person from managing corporations for up to 10 years if:

- Within the last 7 years, the person has been an officer of 2 or more corporations when they have failed; and
- The Court is satisfied that the manner in which the corporation was managed was wholly or partly responsible for the corporation failing and that disqualification is justified; and
- On at least 2 occasions, the person has failed to take reasonable steps to prevent the contravention of the Act; and
- The person has done something that would have contravened a persons directors duties owed to the Company under Section 180(1) & 181 of the Corporations Act – to exercise powers with care and diligence and good faith.

ASIC ORDERED DISQUALIFICATION

Under Section 206F of the Corporations Act the ASIC itself, without Court intervention, may disqualify a person from managing corporations for up to 5 years if:

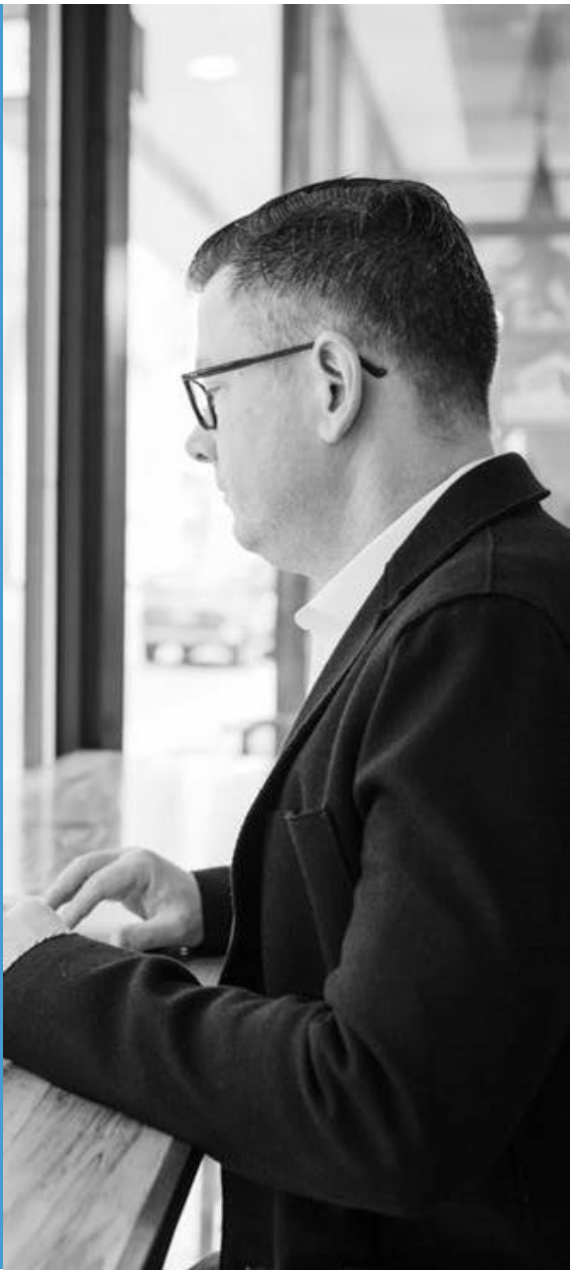
- Within the last 7 years before ASIC gives notice, the person has been an officer of 2 or more corporations when they have failed; and
- While the person was acting as a director or an officer, or within 12 months after the person ceased to be an officer, each of the corporations was wound up and the registered liquidator lodged a report with ASIC regarding its inability to pay its debts

Before disqualification, ASIC must issue a notice to a person requiring them to:

- show cause or demonstrate why they should not be disqualified; and
- The person is to have an opportunity to be heard on the question

ASIC must determine whether the disqualification is justified and it will consider:

- Whether any of the corporations were related to one another
- The person's conduct in relation to the management of the corporations – such as not preventing insolvent trading
- Whether the disqualification would be in the public interest
- Any other matters that ASIC considers appropriate.



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WILL A DIRECTOR BE BANKRUPTED FOR GOING INTO LIQUIDATION?

Firstly, Liquidation is for companies and Bankruptcy is for individuals.

This means that if a company is unable to pay its debts from its own resources, the directors and shareholders do not have to pay those debts personally. It is the company alone that is responsible for paying its debts and if it can't, it is appropriate it be placed into liquidation.

However, a director may have personal liability for company debts in certain circumstances – such as with Director Penalty Notices and tax debts as discussed earlier.

DOES LIQUIDATION AFFECT CREDIT RATING?

There certainly can be an effect particularly if a director attempts to obtain finance whilst the liquidation is being performed. But the effect of winding up a Company is nothing like the severity of personal bankruptcy and will usually lessen shortly after the liquidation has been completed.

SHAREHOLDERS LIABILITY

A shareholders liability is limited to any unpaid capital not paid in relation to the shares allotted to them.

For example, if a shareholder is allotted 10,000 x $1 shares and have paid $10,000 for those shares, they cannot be asked to pay anything further toward the debts of the company. Their liability was limited by the amount of shares purchased and fully paid for.

However, if the shareholder only paid $1,000 for those shares, a liquidator can ask for a payment of $9,000 – being the limit of their liability for the unpaid capital of allotted shares.

DIRECTOR LIABILITY

A director also has no liability for the Company's debts. However, a director may be held personally liable in a number of circumstances, including any director loans owing to the company, debts subject to Director Penalty Notices to the ATO and the following.

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PERSONAL GUARANTEES

A personal guarantee is a legally enforceable agreement that means if the company fails to pay its debts, the guarantor, usually the company director, will become personally liable to repay the company debt.

Very often, a creditor will seek a personal guarantee from a company director to secure the obligations of a company before they will provide any credit account or supply.

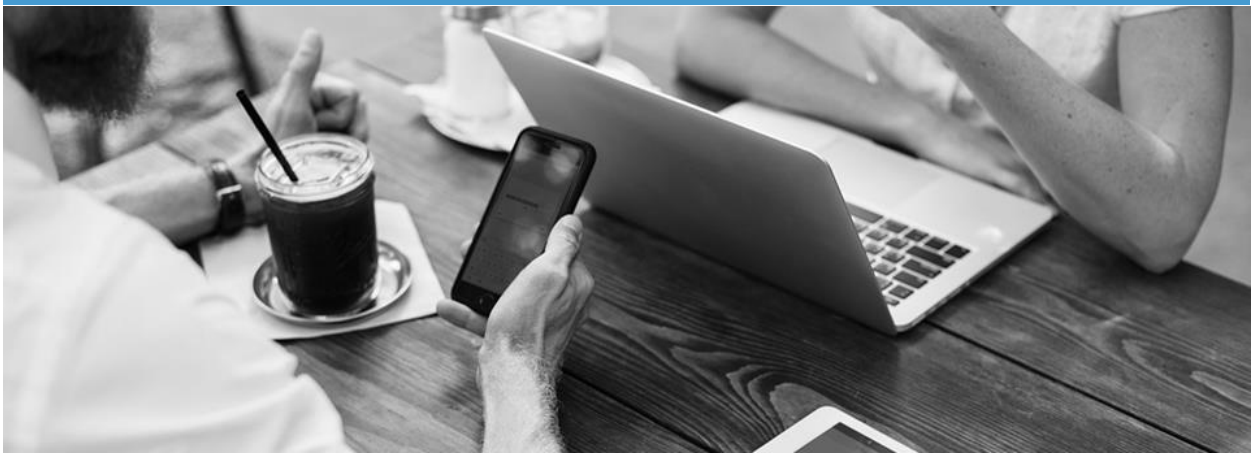
The most common types of personal guarantees are to secure debts owing on:

- Trade supply accounts
- Company credit cards
- Hire purchase and leasing contracts
- Other financing facilities

Often directors are unsure as to whether they have signed a personal guarantee and it is only when a company is facing insolvency that these types of issues assume greater significance to the directors.

The best advice here includes:

- Read and understand every document before signing it.
- Seek competent legal advice before signing any contracts or credit applications that request a personal guarantee
- Keep a copy of all documents signed so that if an issue arises, it can be available for review without having to refer to the person alleging the personal guarantee.
- If a personal guarantee is required by one trader, seek the same supplies from another party that does not require a personal guarantee
- If there is no option but to sign the guarantee, then limit the amount to a level a director is comfortable with.
- If a director leaves a company, they should always write to suppliers where guarantees have been given and withdraw the guarantee, or the ability of the creditor to rely on that guarantee after the date the director has resigned from the company.



INSOLVENT TRADING

A Director must not allow a company to trade and incur debts when it is insolvent otherwise they may become personally liable for the loss and damage caused to the company and its creditors. This could lead to the loss of personal assets of a director.

Insolvent trading is an offence under the Corporations Act. If a director allows a new debt to be incurred knowing the company is insolvent and unable to pay those debts as and when they fall due for payment, the director may be guilty of insolvent trading.

If a director is found guilty of insolvent trading he/she may become personally liable for the repayment of debts incurred after the company became insolvent and this could lead to the loss of personal assets or even bankruptcy.

WHEN IS A COMPANY DEEMED TO BE INSOLVENT?

A company is deemed to be insolvent when it cannot pay its debts as and when they become due for payment.

When determining the question of insolvent trading, the court will consider the overall financial circumstances of a company as a matter of commercial reality.

This means not only will the court review cash flow, but it will also consider the company's balance sheet, asset values and their realisability as well as the ability of the Company to raise funds in terms of equity or debt.

A company may also be deemed to be insolvent in circumstances where the directors do not cause books and records of account to be maintained that would explain the transactions and financial position of the company. In such cases, a company may be presumed to be insolvent for as long as records were not kept.

WHAT ARE DIRECTORS LAWFULLY REQUIRED TO DO?

Directors must:

- stay constantly aware of the financial affairs and position of the company.
- prepare and review financial information regularly in order to determine that there are reasonable grounds to conclude that the company can repay its debts as and when they fall due for payment.
- if they suspect insolvency, take positive steps to confirm the position of the company and realistically assess the available options.
- seek appropriate advice from a suitably qualified person
- act appropriately and in a timely manner to address the question of solvency

WHO CAN MAKE A CLAIM FOR INSOLVENT TRADING?

Liquidators who are able to prove the elements may commence a claim for insolvent trading against directors personally within 6 years of the commencement of the liquidation.

If such an action is not commenced by a liquidator, a creditor, with the consent of the liquidator may bring the action themselves.

WHAT ARE THE SECTIONS OF THE CORPORATIONS ACT THAT DEAL WITH INSOLVENT TRADING?

Section 588G of the Corporations Act sets out the directors' duty to prevent insolvent trading and Section 588M provides the process of a legal recovery for a breach of this duty.

WHAT ARE THE DEFENCES TO A CLAIM FOR INSOLVENT TRADING?

A director may claim defences under Section 588H including:

- there were reasonable grounds to expect the company was solvent
- the director relied on information being produced and supplied by a competent persona that lead to the view the company was solvent
- the director, for good reason, was not involved in the management of the company at the relevant time
- the director took all reasonable steps to prevent the company from incurring the debt
    - the court may consider reasonable steps as including:
        - any action the person took with a view to appoint a liquidator/administrator
        - the timing of any action taken
        - the result of that action

WHAT ARE THE PENALTIES FOR INSOLVENT TRADING?

A director may face civil and criminal sanction for breaches of insolvent trading laws.

Firstly, a liquidator or an individual creditor may bring proceedings against directors personally for compensation for the damages caused.

A director may also face disqualification as a director if they are found guilty of trading while insolvent. Fines of up to $200,000 as well as imprisonment for up to 5 years may also apply.

UNREASONABLE DIRECTOR-RELATED TRANSACTIONS

Liquidators may identify transactions that appear to have little or no benefit to a company but that appear to have only benefited the director or a close associate of the company.

Such transactions may be found to be unreasonable director-related transactions if there was no benefit, or indeed a detriment to the company and the transaction also had the effect of reducing the amount of assets available for distribution in a liquidation. It is not necessary that the company was insolvent at the time of the transaction, so a defence of good faith and no reasonable grounds to suspect insolvency do not apply.

A director may be liable under Section 588FDA to repay or compensate a company for any loss suffered if they cause the company to enter into a transaction that would result in:

- a director, a close associate of the director or a nominee acting on behalf of, or for the benefit of a director or a close associate

receiving an unreasonable benefit from the company. This will typically include transactions involving:

- the payment of money
- transfer of company property
- incurring of obligations for the director's benefit

Close associates may be a relative, spouse, de facto, sibling, child etc.

A transaction may be considered unreasonable if a reasonable person in the same position as the company would not have entered into the transaction considering:

- any benefits the company may have obtained
- any detriment the company may have suffered
- any benefits the other parties to the transaction may have obtained
- any other relevant issues

A reasonable person is considered to be a person with knowledge of the company's financial position and who is not trying to gain a personal benefit, or give a benefit to anyone else, or cause a loss to the company.

Again, the liquidator has the onus of proving a transaction is unreasonable in the circumstances before a claim for compensation can be made and proceedings brought. The liquidator has 3 years to bring such claims to Court. As with all claims, the Court will ultimately decide whether liability exists but the basis of the claim is either there was no benefit to the company, or there was a detriment to the company by entering into the transaction.

Unreasonable director-related transactions must have occurred within 4 years of the date of appointment of the liquidator, or in the event of a voluntary administration preceding a liquidation, the date when the voluntary administrator was firstly appointed.

It should be noted that the loss claimed by a liquidator may exceed the actual value of the transaction entered into. Specifically, if a transaction occurred at undervalue, and that transaction is found to be an unreasonable director-related transaction, a director may be liable for the actual value of the asset transferred rather than simply the amount of the transaction.

UNCOMMERCIAL TRANSACTIONS

Liquidators may also identify transactions that appear to have been of little or no benefit or that actually appear to have been detrimental to the company. Such transactions may be considered uncommercial and may be voided so that the party benefiting from the transaction is required to return the asset or compensate the company. A liquidator has 3 years to commence such a claim.

For a transaction to be considered uncommercial, it must have:

- no financial benefit to the company; or
- cause a detriment to the company
- occurred at a time when the company was insolvent
- involved another person that knew or at least suspected the company was insolvent at the time of the transaction.

Again, these transactions apply when the effect of same was to reduce the amount of assets available for an equitable distribution to all creditors in a liquidation.

As with unreasonable director-related transactions, uncommercial transactions will typically involve:

- the payment or transfer of money
- the transfer of company property
- incurring of obligations for the director's benefit

These types of transactions are often seen as:

- the sale or disposal of company property for undervalue
- the purchase of property at overvalue

and will often involve related parties, related entities, the director or their close associates/relatives.

Uncommercial transactions must have occurred within set periods of the date of appointment of the liquidator, or in the event of a voluntary administration preceding a liquidation, the date when the voluntary administrator was firstly appointed. Those periods differ under Section 588FE depending upon whether the transaction involved related or non-related parties and the purpose behind entering into such a transaction. Specifically:

- 6 months for non-related parties
- 4 years for related parties
- 10 years if the purpose of the transaction is found to have been an attempt to defeat, delay or interfere with creditors rights.

Defences to a claim for uncommercial transactions include:

- That valuable consideration was given
- The party acted in good faith and in the normal course of business
- There was no knowledge or any reason or information in the hands of the other party to suspect insolvency of the company

The onus of proving all three parts of the statutory defence falls upon the defendant to the transaction.

PREFERENTIAL PAYMENTS

A director will not typically be liable for preferential payments however, for the purpose of completeness in terms of a practical guide to insolvency, we include some information on the subject. Firstly, it is noted a liquidator has 3 years from the date of his appointment in which to make a formal claim for the recovery of a preference.

In every liquidation, Liquidators seek to identify and recover monies paid to creditors where it can be shown the recipient knew or suspected a Company was insolvent at the time payment was made.

The primary purpose of the law of Unfair Preference Claims is to ensure that no one creditor should receive more than others in terms of a cents in the dollar return from a winding up.

While the intent of the law is to ensure everyone receives their fair share of whatever remains of an insolvent company, the consequence can be a creditor may be punished for their diligent, efficient and persistent approach to business in favour of other creditors who may not have been as industrious.

However, just because your client receives a demand to repay an unfair preference does not mean all is lost. There are effective ways to respond and retain the benefit of the funds collected.

THE LAW

Section 588FA of the Corporations Act 2001 says a transaction is an unfair preference, given by a company to a creditor, if the Liquidator (who bears the onus of proof) can show:

1. The company and the creditor were parties to the transaction;
2. The transaction resulted in the creditor receiving, in respect of an unsecured debt, more from the company than it would have received from the company if the transaction were set aside and the creditor were to prove for its debt in the liquidation process;
3. The company was insolvent at the time of the transaction or became insolvent as a result of the transaction; and
4. The transaction was entered into during the 6 month relation back period preceding the winding up (or 4 years for a related party) (If Liquidation followed Voluntary Administration, the relation back date is the date upon which the administrators were first appointed to the company).

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WHAT THE LIQUIDATOR NEEDS TO PROVE

To succeed, a Liquidator must be able to demonstrate:

A. The Company was insolvent at the time of the transaction(s); and

B. The creditor knew or ought to have had some knowledge or suspicion the company may have been insolvent and that it could not pay its debts as and when they were due and payable. This is based on an objective or "reasonable person" test.

HOW DOES A LIQUIDATOR PROVE A PREFERENCE?

The Liquidator looks for evidence to prove a creditor knew or ought to have known the company was insolvent at the time of obtaining payment. In this regard, the Liquidator will focus on evidence such as:

- Poor payment history.
- Late payments made well outside of normal trading terms (date of payment -v- the date on the invoice
- Payment arrangements entered into or unilaterally imposed by the creditor.
- Failed payment agreements.
- Dishonoured payments or cheques.
- Threats to cease work or supply.
- Accounts placed on stop credit.
- Other changes to credit terms such as placing the Company on COD plus requiring additional payments to discharging the old debt.
- Seeking a Deed of Acknowledgment or Personal Guarantees before continuing to supply.
- Actual refusal to supply until debt paid.
- Rounded payments not referable to any specific invoice.
- Demands made by the creditor, debt collectors and solicitors.
- Threats to issue a Statutory Demand.
- Issuing a Winding up application.

The Liquidator tries to obtain this evidence from the books of the Company and also a review of all emails and other correspondence from the Company's IT systems. Often, this information is volunteered to a Liquidator by comments made by the creditor.

DEFENDING AN UNFAIR PREFERENCE CLAIM

Firstly, a creditor who receives such a demand should immediately engage a lawyer and avoid any discussion or correspondence with a Liquidator that will (and often does) weaken their position.

A competent lawyer will be aware of the defences available and will draft a response that may result in the creditor retaining all or part of the benefit of the payment obtained by addressing the:

- Running account defence.
- Good Faith defence.
- Set-Off defence.

*Secured creditors (including creditors who hold PPSR) are generally not subject to unfair preference claims.

Of course, certain payments will not be considered preferential such as payments in advance of providing supply or services, cash on delivery (although additional amounts often required may be considered preferential), payments made by third parties outside of the company and subsisting security interests registered on the PPSR.

RUNNING ACCOUNT DEFENCE

Section 588FA(3) of the Act states that where:

1. A transaction is an integral part of a continuing business relationship (for example, a running account) between a company and creditor, and
2. In the course of the relationship the level of the company's net indebtedness to the creditor increased and reduced from time to time as a result of a series of transactions;

- Then all the transactions are taken to be a single transaction for the purposes of establishing whether there was an unfair preference.
- In such a 'continuing business relationship' while a creditor may have recovered payments totalling say, $50,000 in the 6 month relation back period immediately before liquidation, and at the same time they continued to supply $60,000 in the same period.
- There would be no net reduction from the peak indebtedness, and therefore, no preference would exist.

GOOD FAITH, NO KNOWLEDGE AND VALUABLE CONSIDERATION

Section 588FG(2) of the Act states that a Court shall not make an order for a preference or voidable transaction if the creditor can prove that:

1. The person received no benefit because of the transaction.
2. The person acted in good faith,
3. At the time, when the benefit was received:
    - the person had no reasonable grounds for suspecting that the company was insolvent or would become insolvent, and
    - A reasonable person in the creditors position would have had no such grounds for suspecting insolvency, and
4. The person provided valuable consideration for the payment.

While a liquidator may assert a preference has been paid, it is up to the creditor who received the payment to prove their defence if a preference is to be avoided.

SET OFF – SECTION 553C

In a recent Federal Court matter, Stone v Melrose Cranes & Rigging Pty Ltd, in the matter of Cardinal Project Services Pty Ltd (in liq) (CPS)(No 2) [2018] FCA 530, where a creditor has no actual notice of facts that would have indicated to a reasonable person in its position that the debtor company was insolvent, they may be able to offset payments received, that may otherwise be preferential, against their outstanding debt remaining unpaid upon liquidation.

For example, where a creditor was owed $100,000 and was paid $40,000 by preference payments, and the creditor has no actual notice of facts that would disclose the company lacked the ability to pay its debts when they fell due, within the meaning of section 95 of the Act, the creditor could set-off its outstanding debt of $60,000 against the $40,000 preference and not have to disgorge any amount to the liquidator.

CERTAIN INDUSTRY STANDARD PRACTICES

It is possible to defend claims for preferential payments on the basis of standard practice in certain industries. For example, in the building industry it is commonplace for payments to be made well outside of the creditors' normal credit terms.

It is also possible to argue that the debtor and creditor relationship was such that there was a history and an agreement, although unwritten, that payments were often made very late.

EMPLOYEE ENTITLEMENT CLAIMS

Apart from a personal liability for superannuation as noted above, a director may be liable if they cause the company to enter into a transaction that had the effect of reducing the amount of assets available to pay employee entitlements in a liquidation scenario. Such transactions are designed to avoid employee entitlements.

Section 596AB of the Act states that a person must not enter into a transaction with the intention of:

- Preventing the recovery of the entitlements of employees of a company; or
- Significantly reducing the amount of the entitlements of employees of a company that can be recovered.

If a director intentionally enters into such a transaction, a liquidator will have a right to make a claim against that person equivalent to the amount of loss caused or suffered by the priority employee entitlements that are unable to be paid because of the transaction.

BREACH OF DIRECTORS DUTIES

Directors have a number of legal duties that include remaining constantly aware of the financial position of the company and acting in a timely manner to address any solvency issues. This not only requires a director to maintain proper books and records so as to explain the financial position and transaction of the company, but also to:

- Regularly review the company's financial position
- Take active steps to question and confirm the financial position and solvency of the company
- Seek advice from a suitably qualified professional if a problem if suspected
- Act in a timely manner to address any solvency issues.

It is not sufficient to simply attempt to understand the financial position once a year when annual accounts are signed.

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PRESUMPTION OF INSOLVENCY

If a director fails to maintain or retain financial records for the 7 years required by the Corporations Act, a company will be presumed to be insolvent throughout the period in which records were not kept.

This means that if a claim for Insolvent Trading is made, there will be no defence to that action and personal assets may be lost.

DIRECTORS OTHER DUTIES UNDER THE CORPORATIONS ACT

All directors under Sections 180-184 of the Act must:

- Act with care and diligence
- Act in good faith and for a proper purpose
- Not use their position or information improperly or to gain advantage for themselves or to harm the company
- Act dishonestly or recklessly

PHOENIX TRANSACTIONS

ASIC and the Federal Government are extremely concerned about the increase of illegal phoenix activity undertaken by directors and often promoted by unregulated and unlicensed middlemen on the periphery of the insolvency profession.

A Phoenix transaction typically involves the illegal transfer of assets from one company (usually with overwhelming debt) into another (without debt), for little or no consideration, for the purpose of avoiding or defeating the claims of creditors.

While the assets and business operations are transferred into the new company for little or no money, the debt remains in the old company.

The creditors of the old company have no direct recourse against the new company that now holds the assets. Creditors may only attack the old company and seek to have a liquidator appointed who will then investigate the alleged phoenix transaction.

LIQUIDATORS WILL INVESTIGATE AND REPORT PHOENIX TRANSACTIONS

Once a liquidator is appointed, alleged phoenix transactions will be investigated and reported to both creditors and the ASIC. Phoenix transactions are illegal as they are designed to defeat the claims of creditors by leaving no assets or funds available in the old company. Illegal phoenix transactions should never be contemplated.

There are perfectly legal methods of dealing with a company's assets even when a company is in trouble or insolvent.

LIQUIDATORS WILL REPORT AN ALLEGED PHOENIX TRANSACTION

Liquidators who encounter phoenix transactions have a number of options.

First, they may seek creditor assistance and funding under the ASIC Assetless Administration Fund – a fund designed to enable liquidators to report and take action against directors.

LIQUIDATORS WILL REPORT BREACHES OF DIRECTORS DUTIES

An illegal phoenix transaction is a breach of directors duties in terms of breaching the duty of:

- Act with care and diligence
- Act in good faith and for a proper purpose
- Not use their position or information improperly or to gain advantage for themselves or to harm the company
- Act dishonestly or recklessly

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PENALTIES FOR PHOENIX TRANSACTIONS

Directors that engage in illegal phoenix transactions may be liable for:

- Civil penalties of up to $200,000 and compensation orders for the loss caused to a company.
- Criminal penalties including fines and imprisonment
- Director Banning orders and disqualification for up to 20 years in extreme circumstances.

VOLUNTARY ADMINISTRATION CAN IT SAVE THE BUSINESS?

Voluntary Administration is a legal alternative to company liquidation and is appropriate for directors who believe their company is viable and worth saving.

Voluntary Administration is a way in which an insolvent (or soon to become insolvent) company can restructure and compromise its debts so that the business can continue to trade and employ in the future.

The process normally lasts 28-35 days (although it may be extended) and in this time, the Voluntary Administrator will take control of the company and its trading operations and assets. Directors will normally provide assistance during this process.

While trading operations continue, directors will work on a proposal to put to creditors as to how their debts are to be dealt with. Usually, if a proposal is made, it will provide for a better return to creditors than they would receive if the company was immediately placed into liquidation.

Once the proposal is finalised, it is sent to all creditors who then meet and vote on whether to accept it.

Voluntary Administration is most appropriate for companies with substantial businesses or assets considering the costs of such an operation are usually high.

POSSIBLE OUTCOMES OF A VOLUNTARY ADMINISTRATION

Once a proposal is finalised and sent to creditors, a meeting will be held and a vote taken as to whether:

- To accept the director's proposal for the compromise of the debts; or
- To reject the proposal and place the Company into liquidation;

Creditors may also vote to return control of the company to the directors but this rarely occurs as the company is insolvent.

If creditors agree to the proposal, the company goes from Voluntary Administration to a Deed of Company Arrangement – this is where the company will attempt to fulfil the proposal. If creditors reject the proposal, the company will go into liquidation.

ROLE OF THE VOLUNTARY ADMINISTRATOR

The administrator must undertake an investigation into the affairs of the company and to report to creditors the financial position of the company.

The administrator will also report upon the directors proposal and whether he believes the proposal is in the best interests of the creditors.

Usually the administrator will recommend a directors' proposal if it provides for a greater return than creditors would otherwise receive in a liquidation.

The other role of the Voluntary Administrator is to report any breaches of the Corporations Act to the ASIC.

WHAT TYPES OF BUSINESS DOES A VOLUNTARY ADMINISTRATION SUIT?

A Voluntary Administration can be used for any type of business but it is best suited to companies with a substantial business, valuable assets or both.

Voluntary Administration may not be suitable to smaller companies where assets values are limited as the costs of the process can be prohibitive.

For smaller companies with lower value assets, there are other legal options available and you may contact us anytime to find out what they are.

HOW IS A VOLUNTARY ADMINISTRATION BEGUN?

The process of appointing a Voluntary Administrator is usually commenced by a majority of directors making such an appointment. The appointment can also be made by a secured creditor or a liquidator.

When the administrator is appointed he will immediately take control of the company and its operations. Following that, he will start his investigations and report to the creditors and invite them to the first meeting held within the first eight (8) business days.
After the first meeting, the administrator will then conduct a very detailed investigation into the problems of the company and its financial position.

The Administrator will also report to creditors on any proposal made by the directors and whether, in his opinion, the proposal should be accepted or whether the company should be liquidated.

The major report by the administrator calls a second meeting of creditors held at about day 30 – 35 of the administration period.

WHAT HAPPENS AT THE TWO MEETINGS OF CREDITORS?

The first meeting of creditors that is held within 8 days of appointment is fairly basic and procedural in nature.

In this meeting, creditors decide:

- whether or not they wish to replace the current administrator and with whom
- whether the creditors wish to form a committee

The second meeting of creditors is the most important. Creditors have now received the detailed report of the administrator and have had the opportunity of considering the financial position of the company, the proposal of the directors and the likely return under both scenarios.

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CREDITORS WILL THEN BE ASKED TO VOTE ON THE FUTURE OF THE COMPANY AND SPECIFICALLY WHETHER

- To accept the director's proposal and allow the company to enter into a Deed of Company Arrangement; or
- To vote for the liquidation of the company.

DEED OF COMPANY ARRANGEMENT

A Deed of Company Arrangement (DOCA) is a formal and legally binding agreement between a company and its creditors as to how the company's affairs are to be dealt with and how the outstanding debts are to be paid.

Creditors will often agree to a DOCA if they are offered a better return on their outstanding debts than would otherwise be available to them if the company were immediately placed into liquidation.

The voting requirements needed to achieve a DOCA proposal are:

- 50% in number of creditors voting, voting in favour of the DOCA
- 50% of value of creditors voting, voting in favour of the DOCA

Unless both requirements are fulfilled, the proposal will not be passed and will rely on a Voluntary Administrator exercising a casting vote that will usually be cast in line with the recommendation reported to creditors.

If a DOCA is passed by creditors, it binds all unsecured creditors to the agreement – even those that have voted against the proposal.

WHO MANAGES THE DOCA

Assuming a DOCA was voted for by creditors, the company must sign it within 15 business days of the creditors meeting unless extended by the Court. If the company fails to sign, it will automatically go into liquidation with the Voluntary Administrator becoming the liquidator.

Assuming the DOCA is signed, it is usual for the Voluntary Administrator to become the Deed Administrator. The role of the Deed Administrator is set out in the DOCA itself but essentially, that person must ensure the commitments made by the company to the creditors are fulfilled.

HOW ARE CREDITOR CLAIMS TREATED UNDER A DOCA?

The DOCA will stipulate the order in which creditor claims are to be paid. Occasionally, a Deed may propose that creditors are to be paid in the same priority as in a liquidation, other times, a different list of priorities may be agreed.

Whatever the case, a DOCA must ensure employee entitlements are paid in priority to other unsecured creditors. The only exception to this is where eligible employees have agreed to vary their priority claims.

A DOCA can also bind owners of property or those who lease property, and secured creditors if they have voted and agree to be bound by the DOCA.

However, the DOCA agreement once signed, will not prevent a creditor holding a personal guarantee from taking action to recover their debt from the guarantor (that is after the moratorium provided by the Voluntary Administration ends).

WHAT HAPPENS TO TAX LOSSES

Tax losses are usually preserved but may be lost or reduced where the company fails to pay its creditors a return of 100 cents in the dollar.

WHAT HAPPENS IF THE DOCA FAILS

If the terms of a DOCA are not complied with, default has occurred and the Deed Administrator will issue a Notice of Default. If the default is not rectified within the time specified by the Notice, the agreement is breached and the DOCA may be terminated under the agreement itself, by creditor resolution or Court Order.

If the DOCA fails, the company usually enters into liquidation.

SAFE HARBOUR RESTRUCTURING

Restructuring a company may now occur under the protection of the new Safe Harbour laws.

To satisfy the requirements, it is necessary to demonstrate a commitment and capacity to restructure as well as showing the plan is likely to provide a Better Outcome for all involved.

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SAFE HARBOUR: A REFUGE?

The Safe Harbour Laws provide protection to directors to trade for a period, while the Company is insolvent, if by doing so, they will achieve a Better Outcome than would be achieved by immediately placing a company into insolvency.

Should the restructure or turnaround fail, the directors will be afforded some protection for insolvent trading provided that:

- During the period in which the directors are working toward a Better Outcome, they ensure the Company rigorously complies with requirements:
    - To lodge activity statements; and
    - Of adherence to principles of proper corporate governance.

Safe Harbour allows directors, and those advising and funding them (ie. bankers, investors or shareholders) to respond responsibly but assertively to a company's difficulties by:

- Allowing the directors to remain in control while reasonable risks are taken to facilitate the Company's recovery whilst having an eye to the best outcome for all stakeholders. This means considering various options, including formal insolvency.
- The Safe Harbour amendments seek to allow for a better chance of turning a business around and/or preserving value for employees, creditors and shareholders.
- The changes also hope to reduce the stigma of failure and encourage a culture of entrepreneurship and innovation rather than placing the company prematurely into Voluntary Administration or Liquidation.

To be able to enter the Safe Harbour period, a company must:

1. Have developed a plan that is 'reasonably likely' to achieve a Better Outcome than the immediate appointment of an administrator or liquidator.
2. Ensure all entitlements to employees are up to date and paid when they fall due.
3. Ensure all statutory lodgements are up to date.

A BETTER OUTCOME MEANS ONE THAT IS LIKELY TO INCREASE THE RETURN TO CREDITORS THAN THEY WOULD RECEIVE FROM THE IMMEDIATE APPOINTMENT OF A LIQUIDATOR OR ADMINISTRATOR.

A Better Outcome may also be assessed in terms of:

- continuing to employ staff; or
- returning funds to shareholders; or conceivably
- the Safe Harbour may also be used to complete a contract that may improve but not repair the Company's financial difficulties.

THE NEW LAWS DO NOT REQUIRE THE DIRECTORS TO GUARANTEE THE BETTER OUTCOME. DIRECTORS ARE SIMPLY REQUIRED TO TAKE A REASONABLE POSITION ON WHETHER A BETTER OUTCOME MAY BE REALISED.

Interestingly, if plans formulated are not realised, the issue of insolvency type claims may remain and this may even extend to advisors engaged during the Safe Harbour period.

To be able to use the safe harbour legislation, directors need to consider what a liquidator, retrospectively, may consider relevant, including that the board is:

- properly informing themselves of the company's financial position.
- taking appropriate steps to prevent any misconduct that could adversely affect the company's ability to pay all its debts.
- maintaining appropriate financial records consistent with the size and nature of the company.
- obtaining advice from an appropriately qualified entity who is given sufficient information to give appropriate advice.
- developing or implementing a plan for restructuring to improve a company's financial position.
- Resolving to rely on the Safe Harbour provisions.

SAFE HARBOUR APPLICATION

A plan is not enough.

The board should ensure it has access to detailed management accounts that disclose the historical performance, coupled with a reliable reporting regime that regularly provides directors with detailed and accurate financial information so that performance may be tracked and compared to the plan being pursued.

Directors must have absolute confidence in the financial reports, as they will provide:

- evidence of the Better Outcome plan being pursued in Safe Harbour.
- the basis of a defence to directors from an insolvent trading claim if the Better Outcome plan being pursued is not achieved and insolvency cannot be avoided.

Directors considering availing themselves of a safe harbour regime should ensure they choose an advisor with both the qualifications and experience to ensure that all issues are carefully considered and adhered to.

WHY IGNORING THE UNLAWFUL CONDUCT OF CLIENTS IS A BAD IDEA

Advisors who ignore unlawful conduct of clients may be exposed to penalties. In a recent case, Fair Work Ombudsman v Blue Impression Pty Ltd & Ors [2017] FCCA 810, it was found that the external accountant knew of, but ignored, the underpayment of wages by their client. Consequently, the advisor was found to be an accessory to breaches of Section 550 of the Fair Work Act and now faces a potential liability of $378,000.

The problem involved a Fair Work audit of a restaurant business that found significant underpayments to employees. The restaurant sought assistance from its accountant who calculated the correct pay rates, but the client did not update their systems with the correct rates.

A subsequent audit of the same business found the restaurant had not rectified the situation and had actually made further underpayments of wages, loadings, penalty rates, and allowances to its international workers. As a result, Fair Work commenced legal action against the restaurant and its accountant on the basis that any third party involved in a contravention of the Fair Work Act, can also be taken to have breached the Act.

Naturally, the accountant claimed its role was that of a service provider processing payments in accordance with instructions and further, that it had no knowledge of employee duties or award rates that should be applied. However, the Court determined that the accountant, with knowledge of the breach from the earlier audit, chose to ignore the underpayment and this was sufficient to be found an accessory to breaches of section 550. Doing nothing when you have knowledge of a client's unlawful conduct is not a defence.

The Insolvency Experts