

INSOLVENCY SIMPLIFIED: CREDITORS VOLUNTARY LIQUIDATION

1.0 INTRODUCTION

When the directors of a company determine that the company is insolvent and cannot continue its operations or be rehabilitated, then they may, by resolution of its members, wind up the company voluntarily. The relevant legislation regulating creditors' voluntary winding up is Parts 5.5 to 5.9, and Schedule 2 of the Corporations Act 2001 (Cth) ("**the Act**") and the Insolvency Practice Rules (Corporations) 2016 ("**IPR**").

1.1 When a Company cannot be Wound up Voluntarily

Except with the leave of the Court, a company cannot resolve that it be wound up voluntarily if an application for the company to be wound up in insolvency has been filed, or the Court has ordered that the company be wound up in insolvency, whether or not the order was made on such an application.

1.2 When a Company can be Wound up Voluntarily

Subject to section 1.1 above, a company may be wound up voluntarily if the company so resolves by special resolution. If circumstances change substantially post appointment, then a liquidator can appoint an Administrator with a view to propounding a Deed of Company Arrangement.

2.0 THE APPOINTMENT PROCESS

2.1 Directors' Resolution

To initiate a creditors' voluntary winding up, the director(s) generally pass resolutions to the following effect:

- (i) That the company is insolvent and should be wound up; and
- (ii) That a meeting of the members be convened for the purpose of winding up the company; or
- (iii) That a statement setting out the resolutions to wind up the company be circulated to the members.

The resolutions can be passed:

- (a) by the directors circulating a statement of resolutions which they all sign, or in the case of a company with a single director, that director signs the statement; or
- (b) at a formal meeting of directors.

Either way, a Summary of Affairs made out on the prescribed form must be completed, setting out the company's asset and liability position.

Directors will also seek the consent of a registered liquidator, that is required to present to the members.

2.2 Resolutions of Members

Once the directors have resolved that the company should be wound up, the company's members then pass resolutions to the following effect:

- (i) That the company be wound up voluntarily (special resolution); and
- (ii) That a specified person be appointed Liquidator of the company (ordinary resolution).

A special resolution requires at least 75% in number of members' entitled to vote to approve the resolution in order for it to pass, whereas an ordinary resolution is by simple majority.

The resolutions can be passed:

- (a) by the directors circulating a statement of resolutions which all members sign, or in the case of a company with a single member, that member signs the statement; or
- (b) at a formal meeting of members.

2.3 Meeting of Members

If a meeting of members is to be convened, then a director must sign a notice convening a general meeting of members. A general meeting of members can also be convened by members holding at least 5% of the votes that may be cast at a general meeting.

At least 21 days notice of the general meeting is required to



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be given. However, this period can be shortened if 95% of the members consent to short notice. Subject to obtaining this consent, the meeting of members can be held immediately after the meeting of directors.

2.4 Liquidator's Requirements

To conduct a creditor's voluntary liquidation, a person must be registered with the Australian Securities & Investments Commission as a liquidator. Most registered liquidators are also members of the Australian Restructuring, Insolvency and Turnaround Association ("ARITA"). The Act, the IPR and ARITA have a number of requirements that practitioners must follow prior to accepting an appointment as liquidator, namely;

- (i) A liquidator must be independent and seen to be independent. Conflict checks are undertaken prior to accepting an appointment;
- (ii) Liquidators must make directors aware of how they charge for their work, including their hourly rates (if applicable).

A liquidator may seek security for their costs in undertaking the liquidation. This is usually done by a Deed of Guarantee and/or Indemnity and may involve the granting of a security over property.

2.5 Commencement of the Winding Up

When members pass the special resolution to wind up the company, the winding up is taken to have begun or commenced on the day on which the resolution was passed. However, if immediately before the resolution was passed, the company was subject to another form of external administration, then the winding up is taken to have begun or commenced on the day on which the first administration began.

3.0 EFFECT OF THE WINDING UP

Following the appointment, the liquidator administers the winding up process in the same way as a liquidator in a compulsory liquidation.

3.1 Effect on the Company

The purpose of winding up the company is to effectively convert the company's assets into a pool of funds from which creditor claims can be met. The company can only continue to trade so far as is necessary for the purpose of maximising the realisation of its business and assets. Except in specific circumstances, a transfer of shares after the date of winding up is void.

3.2 Effect on Directors and Officers

On commencement of the winding up, the powers of directors and officers relating to the management of the company are suspended.

Within 5 business days from the date of winding up, directors of a company are required to provide the liquidator with a Report as to Affairs in the prescribed form setting out the assets and liabilities of the company as at the date of winding up.

Directors are also required to provide the liquidator with the books and records of the company, and assist the liquidator generally as reasonably required.

These obligations can also pass onto other officers of the company, including former officers.

Failure to comply with these obligations is a criminal offence which carries significant penalties of up to 50 penalty units, or imprisonment, or both.

3.3 Effect on Secured Creditors

The rights of secured creditors are usually not affected by the winding up. It is not uncommon for secured creditors to allow the liquidator to sell their assets on the basis that he or she recognises the rights of the secured creditor. However, in some circumstances, the security itself may not be enforceable against the liquidator.

The secured creditor may prove in the liquidation for any shortfall after taking into account either the value of its security or the proceeds from the sale of the secured property.

3.4 Effect on Unsecured Creditors

Once a company is wound up, unsecured creditors cannot commence or continue recovery action against the company unless they obtain the consent of the court. Their rights are restricted to proving their claim to the liquidator and receiving in due course a pro-rata distribution of the company's realised assets.

The winding up of a company does not limit the rights of creditors to pursue guarantors of the company's debts.

Whilst steps are taken to maximise realisations, the reality is that most liquidations do not pay out any monies to unsecured creditors.

4.0 THE LIQUIDATION PROCESS

4.1 Securing and Realising of Assets

It is the liquidator's responsibility to secure the company's assets and realise them for the benefit of creditors.

4.2 Reporting to Creditors

4.2.1 Initial Report

Following the meeting of members, the liquidator must write to creditors within 10 business days of his or her appointment. The liquidator is required to attach to the report the Summary of Affairs together with a listing of creditors, and lodge these documents with the Australian Securities & Investments Commission ("ASIC").

A liquidator will also provide creditors with a Declaration of Independence, Relevant Relationships and Indemnities. This Declaration is meant to confirm the independence of the liquidator and inform creditors of any indemnities that he or she has received in respect of remuneration.

This declaration must be lodged with ASIC.

A liquidator also informs creditors of their rights in the initial report. The main rights of creditors are:

- (i) Right to request a meeting of creditors;
- (ii) Right to request information regarding the company's affairs and the liquidation process;



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- (iii) Right to give directions to the liquidator (by resolution) (a liquidator must have regard to these directions but is not required to comply);
- (iv) Right to appoint a reviewing liquidator to review an expense of the liquidation or the liquidator's remuneration (by resolution or by agreement);
- (v) Right to replace the Liquidator (this must be done by a meeting).

Creditors also have a special right in creditors voluntary liquidations, to require a liquidator to hold a meeting. The request must be made in the first 20 business days of an appointment, by at least 5% of unrelated creditors.

All rights of creditors are subject to a test of reasonableness.

4.2.2 Statutory Report

Within 3 months of the appointment, a liquidator is required to report to creditors on:

- (i) the estimated amounts of assets and liabilities of the company;
- (ii) inquiries relating to the winding up that have been taken to date;
- (iii) further inquiries relating to the winding up that may need to be undertaken;
- (iv) what happened to the business of the company;
- (v) likelihood of creditors receiving a dividend; and
- (vi) possible recovery actions.

A copy of this report must also be lodged with ASIC.

4.3 Investigation

A liquidator will take possession of a company's books and records for the primary purpose of conducting an investigation into its affairs and the conduct of its directors.

Specific areas of enquiry include the following:

- (i) Trading whilst insolvent and whether or not proceedings should be brought against the directors;
- (ii) Preferential payments and whether or not any monies can be recovered;
- (iii) Uncommercial or undervalued transactions;
- (iv) Transactions with related entities;
- (v) Breaches of the Act.

If necessary a liquidator is able to conduct public examinations of the directors and others, and to make an application to the Court for a warrant to search for and seize property and books of a company and to gain access to property.

Following completion of the investigation, the liquidator is required to report to ASIC on the outcome, including the Liquidator's opinion on whether any further action should be taken.

4.4 Distribution of funds

The liquidator must distribute the proceeds from the realisation of assets in the order of priorities set out in the Act. The order of priorities is summarised hereunder:

- (i) The costs and expenses of the liquidation;
- (ii) The claims of employees for unpaid entitlements; The claims of any secured creditors; The claims of ordinary unsecured creditors.

The claims of directors, their spouses and their relatives for unpaid employee entitlements are limited to \$2,000 each for wages & superannuation and \$1,500 each for other entitlements. The balance of such claims rank as unsecured.

4.5 Reporting to ASIC

Yearly, a liquidator must lodge a return with ASIC regarding the winding up of the Company. A copy of this return is also available to creditors on request.

At the end of the administration, a liquidator must lodge a return with ASIC notifying of the completion of the administration. A copy of this return is also available to creditors on request.

4.6 De-registration

After a liquidator lodges their final return with ASIC, the de-registration process is initiated. ASIC must de-register a company after three (3) months of the final return being lodged.

5.0 PASSING OF RESOLUTIONS BY CREDITORS

Creditors can have significant influence in the liquidation process through the passing of resolutions. Creditors can pass resolutions by:

- (i) Signing a Proposal Notice;
- (ii) At a meeting of creditors.

5.1 Proposal without meeting

A liquidator may seek certain resolutions by requesting creditors to complete and return a Proposal Notice. Creditors may also ask the liquidator to put a resolution to the creditors.

Proposal Notices can be used in circumstances where a meeting of creditors is not required. They are intended to reduce the costs of convening and holding a meeting.

In order to be entitled to vote by Proposal, a creditor must prove their debt using a Proof of Debt form which will accompany the Proposals.

Creditors can:

- (i) Accept the Proposal;
- (ii) Reject the Proposal;
- (iii) Object to the Proposal being resolved without a meeting of creditors being held.



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A resolution of creditors is passed if:

- (a) a majority in number of creditors accept the Proposal; and
- (b) a majority in value of creditors accept the Proposal; and
- (c) not more than 25% in value of creditors object to the Proposal without a meeting of creditors being held.

5.2 Meeting of Creditors

Meetings of creditors are not automatically required in voluntary liquidations. However, meetings of creditors are required in certain circumstances. Examples of this are:

- (i) where a liquidator needs to compromise a debt due to a company that is over \$100,000;
- (ii) where a liquidator needs to enter into an arrangement that lasts longer than 3 months;
- (iii) where a Committee of Inspection is warranted. Such a committee is a body of creditors that represents all creditors;
- (iv) where creditors seek to replace the liquidator.

Creditors should be aware of their rights to request a meeting of creditors.

Please refer to our technical guide on voting at meetings of creditors for further information.

6.0 LIQUIDATOR'S REMUNERATION

6.1 Approval of Remuneration

A liquidator is entitled to remuneration as determined by a Committee of Inspection, creditors or the Court. A liquidator must prepare a report setting out:

- (i) such matters as will enable the committee, or the creditors, to make an informed assessment as to whether the proposed remuneration is reasonable; a summary description of the major tasks performed; or likely to be performed, by the liquidator; and the costs associated with each of those major tasks.

There is no fixed scale of remuneration. The Code of Professional Practice issued by ARITA sets out principles and guidance as to how remuneration is to be claimed. In most windings up, a fee based on time spent on tasks is appropriate, while other methods of calculation may be warranted in certain cases. The Code also contains requirements for disclosure of fee rates and estimates of total fees to be charged in a winding up.

Approval of remuneration can be sought by a liquidator at any time. It is generally sought at the time the liquidator issues either their initial, or statutory report to creditors.

In windings up where there is no remuneration approved for whatever reason and certain conditions have been complied with, the creditors are taken to have resolved that the liquidator may claim up to \$5,000 in remuneration, which is indexed annually from 1 July 2017

6.2 Where a Liquidator's Remuneration is not Approved

Where creditors choose to not approve a Liquidator's remuneration claim, a liquidator has the option of:

- (i) seeking approval from creditors at a later date;
- (ii) seeking approval from the Court.

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