

Insolvency Appointments where urgent action is required The growth of creditor's voluntary winding-up

The last year has seen insolvency practitioners increasingly encounter situations in which the controllers seek to have a company wound up immediately by means of a creditor's voluntary winding-up as provided for by ss 491 and 497 of the *Corporations Act 2001 (Act)*.

All that is required for a creditors winding-up is:

1. A valid Special Resolution of the company to that effect. This will usually occur in a general meeting of members (shareholders); and
2. A Special Resolution of the company appointing a liquidator for the purpose of winding-up the affairs of and distributing the property of the company pursuant to s 499(1) of the Act.

The two resolutions will usually be made at the same meeting. Before a liquidator can be appointed by Special Resolution, the proposed appointee must have consented to act.

The liquidator takes office immediately upon appointment by the company in the general meeting and his or her main duty is to convene a creditors meeting within 11 days of the meeting at which the liquidator was appointed.

A liquidator acting in a creditor's voluntary winding-up has essentially the same powers and duties, including performing investigations, realising assets and making distributions, as a liquidator appointed by the Court.

Advantages of creditor's voluntary winding-up

Speed

The primary advantage of the creditors voluntary winding-up procedure is speed. In most cases, proprietary companies have a constitution which will allow members in a general meeting to abridge the notice period required for the holding of a general meeting so that a special resolution can be considered virtually immediately.

Speed in the making of an appointment is important as in certain situations an immediate appointment may protect the position of Directors with respect to:

1. Liability for insolvent trading under s 588G of the Act – an appointment may prevent liability arising as it will usually signal the cessation of trading and will preserve the company's assets; or
2. Liability under a notice given by the Australian Taxation Office to Directors pursuant to s 222AOE of the *Income Tax Assessment Act 1936 (Tax Act)*.

Cost

Creditor's voluntary winding-up may also be preferred because the likely appointee's fees will usually be lower than required for voluntary administration. One reason for this is that the appointee in a creditor's voluntary winding-up needs to convene one meeting rather than the minimum two required in voluntary administration.

Internal disputes

A creditor's voluntary winding-up may be an appropriate way to cease business activity where there is a breakdown between the shareholders of a company and the Director or Directors or where a Director or Directors are unable to act (due to illness or absence for example). A voluntary winding-up can also be used for this purpose if the company is solvent (in which case the process is known as a member's voluntary winding-up).

Alternatives to creditor's voluntary winding-up

Other fast means of obtaining appointments which will may lessen the risk of liability for insolvent trading and, in relation to voluntary administration, under the Tax Act are the procedures of voluntary administration and provisional liquidation.

Voluntary administration

The appointment of a voluntary administrator under Part 5.3A of the Act is now well understood and has effectively the same effect as creditor's voluntary winding-up in protecting the position of Directors in relation to liability for insolvent trading and under the Tax Act.

Voluntary administration is less attractive than creditor's voluntary winding-up in that:

1. In voluntary administration, the appointee's fees will usually be higher, including for the reasons set out above; and
2. There is some risk that the Courts may intervene to set aside an appointment of a voluntary administrator where the voluntary administration procedure is being used as a means to obtain a winding-up, in light of the objects of the Part as set out in s 435A of the Act.

At the same time, however, voluntary administration as compared to a creditor's voluntary winding-up may be preferred where the Directors of the company have decided an immediate appointment is necessary but for whatever reason a prompt meeting of members cannot be convened to consider a resolution for winding-up. This is because the company, through its directors, usually makes the appointment of a voluntary administrator.

Voluntary administration, of course, also provides the advantage of allowing for a reconstruction plan to be effected by means of a Deed of Company Arrangement.

Whilst the circumstances we are addressing mainly deal with situations where a company needs to stop trading quickly, it should be observed that voluntary administration is in a number of ways less "terminal" than creditor's voluntary winding-up in that:

1. Some company contracts will be terminated upon winding-up but not necessarily in voluntary administration. For example voluntary administration is less likely to trigger long term employment liabilities;

2. A voluntary administrator has significantly more scope to trade a business than a liquidator, meaning the asset value of the business may be maintained for sale purposes (increasing the return for creditors); and
3. Where a Deed of Company Arrangement is entered into by a company with a continuing business, the company may be able to make use of carried forward tax losses.

Provisional Liquidation

A final possibility is that a company may apply for its own winding-up on the ground of insolvency and do so accompanied by an application to appoint a provisional liquidator. It should be noted, however, that this procedure does not act to prevent or reduce potential liability under the Tax Act.

This procedure was relatively common in cases requiring a fast appointment before the introduction of the voluntary administration procedure. Applications for appointment of a provisional liquidator are relatively expensive but may be necessary to avoid or minimise potential liability for insolvent trading where, for example, a shareholders meeting cannot be convened for whatever reason and a view is formed that recourse to voluntary administration would be inappropriate.

Safeguards for creditors in creditor's voluntary winding-up

The creditor's voluntary winding-up procedure entails risks for those involved including the following:

1. Creditors may seek to set aside an appointment based on an actual or perceived connection between the liquidator and the shareholders of the company;
2. In certain extreme cases, if it is clear that the appointment is made for some ulterior purpose, such as tactical advantage in litigation, the Court may set it aside as an abuse of process; and
3. If an appointment is found after an initial review to have been premature, there is no straightforward procedure which allows the company to return to its controllers, as is possible in voluntary administration.

Safeguards are built into the Act to address such concerns, including based on the recent legislative changes brought about by the *Corporations Amendment (Insolvency) Act 2007* which have been operative from 31 December 2007.

The most important safeguards are the following:

1. A resolution for winding-up cannot be validly made, other than with leave of the Court, if there is an application for the company to be wound up in insolvency before the Court or the Court has ordered that it be wound-up in insolvency. This means that shareholders of a company cannot seek to frustrate a Court appointment of a particular liquidator they wish to avoid by seeking to appoint an alternative person shortly before or after an order is made. In applications for leave, the Court will usually seek the views of the main creditors of the company before allowing a creditors' winding-up to proceed; and
2. Under new s 506A of the Act, between the special resolution for winding-up and the meeting of creditors, a liquidator appointed by a company must now circulate to creditors a "Declaration of Relevant Relationships". This is a written declaration, dealing in a comprehensive way with any potential conflicts of interest. Having

received the declaration, creditors at the creditors meeting are entitled under s497(10) of the Act to resolve to remove the liquidator from office and appoint another person as liquidator instead.

Risks for insolvency practitioners

Due to the potential for appointments to be overturned by the creditors and by the Court, insolvency practitioners need to be cautious when considering approaches from controllers of companies to act as liquidator in a creditors' winding-up. The following should be kept in mind.

Firstly, the appointee should determine who the members of the company are, confirm their identity and determine the legal requirements under the constitution of the particular company and the Act for the making of a special resolution.

Secondly, an appointee should take care in determining what "relevant relationships" may exist for the purpose of providing the required declaration before the creditors meeting. Failure to provide the declaration is an offence.

Thirdly, the appointee will need to perform preliminary investigations into the company to determine whether the company has sufficient assets to meet the cost of convening the creditors meeting and performing initial investigations before a consent is given. Due to the disclosure required before the creditors meeting and the potential for removal by the creditors or the Court, insolvency practitioners should be careful before deciding to consent to act based on an indemnity proffered by a company's controllers.

Conclusion

Creditors voluntary winding-up can be an effective means of ensuring that an insolvency appointment is made to a company in financial difficulties, in particular to avoid or reduce the potential of Director's liability for insolvent trading.

Before taking steps toward such an appointment, however, those associated with the company (Directors, shareholders and employees) need to understand the effect of an appointment upon them and insolvency practitioners need to take steps to ensure that an appointment is legally valid and that all relevant disclosure requirements are made to creditors.

Cowell Clarke has a large team of specialist lawyers with extensive experience in providing practical and strategic advice to companies, directors and insolvency practitioners in relation to the operation of corporate insolvency laws. If you or your clients require assistance in relation to a potential creditor's voluntary winding-up or any insolvency-related issues, we would be pleased to assist you. You can contact us on (08) 8228 1111.

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