

INSOLVENCY AND AVAILABLE OPTIONS

Corporations Act 2001 - Section 95A

95A Solvency and insolvency

- (1) *A person is solvent if, and only if, the person is able to pay all the person's debts as and when they become due and payable; and*
- (2) *A person who is not solvent is insolvent.*

Evidence of Insolvency

Some of the signs of insolvency include but are not limited to the following:

- trading losses;
- net asset deficiency;
- reduced turnover;
- failure to pay statutory debts including GST, workers compensation premiums, PAYG, superannuation;
- delayed payment to non essential creditors;
- part payments and instalment plans with essential creditors;
- dishonoured cheques;
- average aged creditor days increasing;
- average aged debtor days increasing;
- deferral of needed capital expenditure / allowing plant and equipment to become dilapidated;
- bank asking for account to be moved/terminated;
- lessor of assets seeking to retake possession;
- COD terms being imposed by essential suppliers;
- essential suppliers requiring personal guarantees;
- loss of key personnel / high staff turnover;
- reliance on one major project or one major creditor for current or future cash flow;
- receipt of winding up notices / court proceedings for outstanding debts; and
- injection of director's own resources to provide short-term cash flow / relief.

When a Company is insolvent or is likely to become insolvent, it's important that the Director immediately take steps to either arrest and reverse the position or else appoint a Voluntary Administrator or Liquidator.

Depending upon the existing financial position of the Company, the options available to the Company include but are not necessarily limited to those outlined below.

1. Financing Existing Assets of the Company

Financing or refinancing existing assets (or debt facilities) of the Company may be an option available to the Company. Financing existing assets of the Company includes but is not limited to the following:

- an invoice discounting / factoring facility for the Company's debtors;
- a sale and lease-back or other type of facility for the Company's plant and equipment;
- an inventory finance facility for the Company's stock; and/or
- other forms of finance including an overdraft or term debt.

2. Injecting External Capital into the Company

Injecting external capital into the Company may be an option available to the Company. Injecting capital into the Company normally comes in two forms:

- debt in the form of loans (or other) to the Company from Directors, shareholders or third parties; or
- equity in the form of monies raised by the Company from either existing shareholders or new shareholders.

3. Informal Arrangements

An informal arrangement with the Company's creditors (both secured and/or unsecured) may be an option available to the Company. Informal agreements with both secured and unsecured creditors include:

- a moratorium of payments for a defined period while the Company continues to trade;
- a compromise, release or a reduction of the Company's current unsecured creditors;
- if applicable, instalment payments with the Australian Taxation Office and other statutory bodies; or
- a restructure of the secured finance facilities of the Company.

4. Merger or Sale of the Existing Business to a Third Party

A merger of the existing business or a sale of the business or business assets of the Company to a third party may be an option available to the Company. It is important to engage a Professional Business Sales Broker or other advisor and widely advertising the business especially amongst competitors.

5. Sale of the Existing Business or Business Assets to a Related Party

The sale of the existing business or business assets of the Company to a Director of the Company or a related party to the Company may be an option available to the Company.

The Director of the Company and all related parties must ensure that as a minimum their fiduciary and statutory duties are not brought into conflict. Generally this requires the Director of the Company to ensure that the creditors of the Company are not disadvantaged by the process.

It is critical the Directors of the Company do the following:

- widely advertise the business;
- engage a Professional Business Sales Broker or other advisor;
- directly market the business with competitors;
- obtain valuations of all assets;
- pay an appropriate price for all assets purchased (this would vary in the circumstances, but generally exceed the auction valuation and may equate to a going concern valuation);
- if contracts are adopted or entered into by an associated entity, the Company must be compensated for any goodwill loss it suffers; and
- where profitable contracts are adopted by an associated entity the Company must receive the market value of the benefit of the contract.

6. Appointment of a Voluntary Administrator

The appointment of a Voluntary Administrator may be an option available to the Company. The Company may be able to avoid Liquidation by entering into Voluntary Administration. The appointment of a Voluntary Administrator may also be the only option available to Directors seeking to avoid being personally liable for certain debts incurred by the Company.

The Voluntary Administrator's objective is to manage the business, property and affairs of the Company in a way that:

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

The Administration period is typically only 28 days after which a proposal for the future trading of the Company usually takes effect.

Summary of process for appointment of a Voluntary Administrator:

Day 1: Appointment of Voluntary Administrator

- The Voluntary Administrator assumes control of Company.
- Directors' powers cease and liability for insolvent trading for any fresh debts ceases.
- Moratorium on creditors' claims imposed.

Day 7: (approx) 1st Meeting of Creditors

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

Day 21: (approx) Report by Administrator Issued

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

Day 28: (approx) 2nd Meeting of Creditors

- Creditors determine the Company's future.

While the Company is under Voluntary Administration the Voluntary Administrator assumes sole responsibility for the Company's operations. Directors have no authority to deal with any of the assets or perform any management function without the express written consent from the Voluntary Administrator.

After the expiration of 28 days (approximately), a rescue plan or reconstruction of the Company may be implemented by a formal agreement with creditors known as a Deed of Company Arrangement (DCA).

Contents of a Deed of Company Arrangement

The content of a DCA is dependent upon the Company's circumstances. A DCA will typically be a binding agreement between a Company and its creditors, which provides for new terms for the repayment (partial) of existing debts.

The new terms may include any of the following:

- a moratorium of payments to creditors for a defined period;
- the Company continues to trade;
- compromise, release or reduction from a Company's current unsecured debts (normally this is in consideration of an undertaking by the Company to repay a new reduced debt to its creditors by a lump sum or by periodic payments to a fund controlled by a DCA Administrator);
- merger, sale or closure of existing operations;
- ability to use tax losses is potentially preserved;
- takeover of operations of the Company by a new entity;
- injection of new management, capital or other expertise into the new entity without the burden of existing creditors;
- reorganisation of loans and shareholdings; and
- debt forgiveness by stakeholders.

Typically, a DCA would include a binding agreement on all creditors (except secured creditors) to accept a certain number of cents in the dollar in full and final settlement of all creditors claims.

For more information please visit www.asic.gov.au or www.ipaa.com.au

7. Liquidation

Placing the Company into Liquidation may be an option available to the Company.

The objectives of Liquidation are to:

- provide a means to terminate or wind up the affairs of a Company, including its business;
- prescribe a procedure for an orderly realisation of a Company's assets including potential conduct of any causes of action in favour of the Company;
- ensure the fair and equitable distribution of a Company's assets to creditors and, where a surplus exists, to the Company's shareholders;
- permit an independent investigation of the Company's activities and the conduct of its Directors with regard to the circumstances that lead to the Company's Liquidation; and
- undertake the final step of ending the company's existence by attending to its dissolution (termination).

The Directors of the Company placed into liquidation may be faced with having to deal with any or all of the following possible sanctions:

- certain transactions the Company may have entered into with third parties or the Directors may be reversed by a Liquidator;
- the Directors may be liable to compensate the Company for all debts it incurred for the period where it is possible to show that those debts were incurred when it could not be reasonably expected that the Company would be able to pay its debts as and when they fell due;
- the Directors and other officers of the Company being found by the Liquidator as having previously acted in breach of their duties to the Company and being liable to compensate the Company for losses suffered as a result;
- the winding up becoming a triggering event of default in relation to any collateral security or personal guarantee given by any person in support of loans to the Company;
- personal liability on the part of Directors for:
 - unpaid wages and superannuation where it is alleged that arrangements were entered into to avoid payment of these by the Company;
 - any unpaid superannuation guarantee charge;
 - any unpaid PAYG withholding amounts due by the Company;
 - unpaid workers compensation premium; or
 - certain taxation assessments and penalties unpaid including PAYG; and
- the Liquidator may take control of the Company's business and sell it at a "fire sale" price and the Directors will cease to be involved in that business (a sale at less than true value may mean that the Directors exposure under any personal guarantees may also increase).

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Conclusion

Whatever option is adopted by the Directors of the Company it is critical the Directors take appropriate legal advice and are mindful of the potential for there to have been a breach of:

1. common law duties owed by Directors including:
 - to act in good faith;
 - to avoid conflicts of interest;
 - to exercise powers for a proper purpose;
 - to act in the best interest of the company;
 - to act with a degree of care and diligence that a reasonable person would exercise in the circumstances; and
 - to not make improper use of information or their position for gain for themselves or any other party; and

2. provisions of the *Corporations Act* which may include the following:

Section 588FA	the giving of unfair preferences to creditors;
Section 588FB	allowing the Company to enter into uncommercial transactions;
Section 588FD	uncommercial loans to the Company;
Section 588FDA	unreasonable Director-related transactions;
Section 588FGA	requirement on the part of Directors to indemnify commissioner of taxation if certain payments made by the Company are liable to be set aside;
Section 588FJ	floating charges created within 6 months before relation backdate;
Section 588G	director's duty to prevent insolvent trading (incurring of debts while the Company is insolvent);
Section 596AB	Entering into a transaction to avoid employee entitlements
Section 180	Director failing to exercise due care and diligence;
Section 181	Director not acting in good faith;
Section 182	Director making improper use of position;
Section 183	Director making improper use of information;
Section 183	Director dishonestly not acting in good faith (criminal sanction);
Section 191	Failure to notify other Directors of material personal interests when in conflict;
Section 197	Director liable for debts incurred by a corporation as trustee; and
Section 1317H	Director liable to compensate the Company for damage suffered as a result of contravention.