



ADVISORY

# Insolvency Explained: Creditors Voluntary Liquidations

Creditors' voluntary liquidations (CVL) are a formal insolvency process that occurs when the company's directors and subsequently its members determine that the company is insolvent, or likely to become insolvent and can no longer satisfy its debts. The winding up and appointment of a liquidator occurs pursuant to a special resolution passed by the members of the Company. The relevant legislation surrounding this process can be found in Parts 5.5 to 5.9, and Schedule 2 of the Corporations Act 2001.

A CVL allows for the appointment of a qualified person (the Liquidator) who is tasked with immediately realising the Company's Assets for the benefit of the creditors of the company, whilst allowing the liquidator to conduct an investigation into the affairs of the Company for the purpose of reporting to creditors the reasons for the Company needing to be liquidated.

A company cannot be wound up voluntarily if a winding up application has been filed with the court, or if the court has already ordered for the company to be wound up.

## Appointment Process

The Appointment Process is a two-step process, which generally requires the directors to initiate discussions with an insolvency practitioner, to enable the directors to understand the liquidation process, obtain relevant documentation to assist with the appointment and to be provided with information regarding their obligations if the company is placed into liquidation.

The two-step process is as follows:

### 1. Resolutions of Directors

The directors of the Company, either at a meeting of directors or by circulating resolution, must pass resolutions which include:

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

In addition, a Summary of Affairs (Form 509) must be completed by the directors. This form sets out the asset and liability position of the company and is tabled at the meeting of members. This form will be subsequently lodged with the ASIC following the appointment of the Liquidator.

Furthermore, a Consent to Act is required to be obtained from a registered liquidator, consenting to their appointment as Liquidator of the company.

### 2. Resolutions of Members

Following the passing of the Director's resolutions, the company must convene a meeting of members for the purpose of passing members resolutions either by way of circulating resolution or a formal meeting. These resolutions must include the following:

- A special resolution that 'The company be wound up Voluntarily'; and
- An ordinary resolution that a specified person, namely the person providing the Consent to Act, be appointed as liquidator of the company.

The Corporations Act requires that for a special resolution to be passed 75% of the members entitled to vote, in number, approve the resolution, whilst the ordinary resolution only requires 50% approval of the members.

The Corporations Act requires that 21 days notice of the general meeting of members is required to be provided in writing to each member entitled to vote at the meeting and to each director. However, this period can be shortened as required with at least 95% of members entitled to vote agreeing to the short notice prior to the commencement of the Meeting. Accordingly, this allows for the meeting of members to be held immediately following the meeting of directors.

## Who can act as Liquidator

The Corporations Act, together with industry standards set out the various **requirements** that practitioners must follow prior to accepting an appointment as liquidator, namely;

- The person must be registered by the ASIC as a Registered Liquidator;
- A liquidator must be independent and seen to be independent. Accordingly, their dealings with the company prior to accepting the appointment must be limited. To this end conflict checks are undertaken prior to accepting an appointment and disclosure of relevant relationships are made in a declaration of independence and relevant relationships following their appointment; and
- They must provide directors with information regarding the costs of the liquidation, together with information on their hourly rates.

The Liquidators remuneration will generally be paid from the assets of the Company, where the company has sufficient unencumbered assets to meet these costs. Where insufficient assets exist, the liquidator may seek an upfront contribution from the directors to meet the costs of the liquidation or alternatively, they may seek that the directors provide a Deed of Guarantee and/or Indemnity to meet these costs.

## Effect of the Winding Up

The winding up of the company is taken to have commenced on the day the members pass the special resolution to wind up. The passing of the resolution has the following effects on the key stakeholders:

### The Company

The Liquidator immediately assumes control of the affairs of the Company, with the sole purpose of winding up its affairs. In the event that the company is operating a business at the time the resolution is passed, the liquidator is likely to cease operating the business immediately (if it is unviable) or alternatively, operate it for a short period of time to allow a sale as a going concern, which would maximise the value of the assets of the Company.

The Liquidators role is to convert the assets of the company into a pool of funds, to enable the company to satisfy the claims of its creditors, where possible.

### The Directors

Immediately upon the commencement of the winding up, the **powers of directors and officers** are suspended, and they are unable to act without the consent of the Liquidator.

The Directors are required to provide the liquidator with the books and records of the company, and to assist the liquidator as reasonably required. This assistance includes providing access to the assets of the Company and assisting with their realization where required.

Within 5 business days from the date of winding up, the directors of a company are required to provide the liquidator with a Report on Company Activities and Property (ROCAP) in the prescribed form, which provides greater detail on the history of the company and particulars of the assets and liabilities of the company as at the date of winding up.

In the event that the directors breach these obligations, the liquidator has avenues to seek compliance by the directors, including obtaining the assistance of the ASIC which may prosecute the directors for failure to comply with these obligations, which is a criminal offence that has significant penalties.

### The Secured Creditors

The **rights of secured creditors** are usually not affected by the winding up. The liquidator will have a period of seven (7) days to make a decision on the various secured assets of the Company. Where there is no equity in these assets, the liquidator will disclaim their interest in the finance agreement and allow the secured creditor to repossess the asset, to enable it to crystallise its position. On occasion, the secured creditors may allow the liquidator to sell their assets and remit the proceeds from the sale.

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

### The Unsecured Creditors

Following the appointment of the liquidator, **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.

## Liquidation Timeline

### Day 1 tasks

Following the appointment, the liquidator will attend to their initial statutory requirements including ASIC lodgments and other notifications. They will take steps to secure and realise the assets of the company, including writing to banks to freeze accounts, securing the assets and instructing valuers to conduct assets valuations.

The liquidator will generally correspond with creditors holding security over the assets of the Company, to determine the best asset realization strategy.

### Initial Creditor Correspondence and Creditors Rights

The Corporations Act requires that within 10 business days of appointment, the liquidator provides an initial report to creditors that informs creditors of their appointment, provides information regarding the affairs of the company and details their main rights including:

- Right to request a meeting of creditors;
- Right to request information regarding the company's affairs and the liquidation process;
- Right to give directions to the liquidator (by resolution) (a liquidator must have regard to these directions but is not required to comply);
- Right to appoint a reviewing liquidator to review an expense of the liquidation or the liquidator's remuneration (by resolution or by agreement);
- 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.

### Statutory Report to Creditors

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

- The estimated amounts of assets and liabilities of the company;
- Inquiries relating to the winding up that have been taken to date;
- Further inquiries relating to the winding up that may need to be undertaken;
- What happened to the business of the company;
- Likelihood of creditors receiving a dividend; and
- Possible recovery actions.

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

## Liquidators Investigations

During the liquidation the liquidator is required to conduct various investigations into the affairs of the Company and the conduct of its directors including

- If the company traded whilst insolvent and whether or not proceedings should be brought against the directors;
- Preferential payments and whether or not any monies can be recovered;
- Uncommercial or undervalued transactions;
- Transactions with related entities;
- Breaches of the Act.

If the liquidator believes it would assist their investigations they may conduct public examinations of the directors and others to assist in obtaining further information.

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.

## Distribution to Creditors

The liquidator must **distribute the proceeds** from the realization of assets in the order of priorities set out in the Act. The order of priorities is summarised as:

- The claims of any secured creditors, payable from non-circulating assets;
- The costs and expenses of the liquidation;
- The claims of employees for unpaid entitlements;
- The claims of any secured creditors, payable from circulating assets; and
- 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.

## Yearly Obligations and Finalisation

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

The winding up must be completed as soon as practicable and upon completion, the 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.

After the final return is lodged with ASIC, ASIC must de-register the company after three (3) months of the final return being lodged.

## Creditor Powers and Passing Resolutions

The Creditors of the company can have significant influence in the liquidation process through utilising the rights available to them, as discussed above, and participating in the passing of resolutions that are put forward by the Liquidator. These resolutions may cover things like remuneration, destruction of books and records, or other approvals sought by the liquidator. The liquidator will seek to have these resolutions pass by either of the following:

### Resolutions Passed by Proposal Notices

A liquidator may seek approval of certain resolutions by requesting creditors complete and return a **Proposal Notice**. The use of the proposal notices is intended to reduce the costs of convening and holding a meeting of creditors.

It is noted that creditors may object to proposal being resolved without a meeting of creditors being held and accordingly, the liquidator will be required to convene a meeting for the purposes of passing these resolutions.

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 Proposal forms. The liquidator will then adjudicate on this proof for voting purposes.

In respect to each individual resolution, the creditors can exercise their rights by:

- Accepting the Proposal;
- Rejecting the Proposal;
- Objecting to the Proposal being resolved without a meeting of creditors being held.

A resolution of creditors is passed if:

- A majority in number of creditors accept the Proposal; and
- A majority in value of creditors accept the Proposal; and
- Not more than 25% in value of responding creditors object to the Proposal without a meeting of creditors being held.

### Resolutions Passed at Meeting of Creditors

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

- Where a liquidator needs to compromise a debt due to a company that is over \$100,000;
- Where a liquidator needs to enter into an arrangement that lasts longer than 3 months;
- Where a Committee of Inspection is warranted; or
- Where creditors seek to replace the liquidator.

A resolution of creditors is passed at a meeting of creditors on the voices, unless a poll is demanded. Where a poll is demanded the resolution is passed if both:

- A majority in number of creditors vote in favour the Resolution; and
- A majority in value of creditors vote in favour the Resolution; and

Where a split decision is reached, ie. Number but not value or vice versa, then the chairman may exercise a casting voting on the resolution. It is noted that a Liquidator may not exercise a casting vote in favour of a resolution in which they have a financial interest, namely resolutions in respect to their remuneration.

## Liquidator Remuneration

A liquidator is **entitled to remuneration** as determined by a Committee of Inspection, creditors or the Court.

In order to obtain approval, a liquidator must prepare a report setting out such matters that will enable the committee, or the creditors, to make an informed assessment as to whether the proposed remuneration is reasonable. This report will include 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. In most liquidations, a fee based on time spent on the tasks is appropriate, while other methods of calculation may be warranted in certain cases. There are also requirements for disclosure of fee rates and estimates of total fees to be charged in the liquidation.

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 \$5,500 in remuneration, which is indexed annually.

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

- Seeking approval from creditors at a later date; or
- Seeking approval from the Court.

In both of these instances, it is likely the Liquidator will incur additional costs in the liquidation which will be paid from the monies held by the liquidator and will ultimately reduce the pool of available funds for the creditors of the company.