Global Economic Downturn fact sheet

Insolvency – liquidation

Series 1 – Issue 4 (Part 1)

As part of the Institute's ongoing efforts to provide members with guidance and information on key issues affecting the current business environment, the Institute have developed a practical factsheet series, which presents guidance for members written by members.

Involuntary and voluntary liquidation

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When a company is unable to pay its debts as they fall due it is regarded as being insolvent. At this point in time, both creditors and directors should be concerned that the company deal with the insolvency as soon as possible. Creditors will clearly be concerned as to the repayment of their debt and directors ought to be concerned for their personal liability as a result of insolvent trading.

Traditionally, insolvency has been dealt with by way of liquidation of the company, this is explained in the fact sheet. Insolvency of the company may be dealt with in other ways by the appointment of an administrator in voluntary administration or secured creditors may have a right in their lending documents to appoint a receiver to control the assets subject to the security. These other ways will be the subjects of future factsheets.

Liquidation

The liquidation is governed by the provisions in the Corporations Act. There are two broad forms of liquidation allowed for: involuntary and voluntary liquidation.

Involuntary liquidation

Involuntary liquidation is usually where the court orders that the company be wound up. The most common situation is where a creditor applies to the court to have the company wound up on the basis of insolvency. The creditor is also expected to nominate a liquidator to be appointed. The applicant creditor must prove to the court that the company is insolvent in terms of being unable to pay its debts as and when they fall due. The applicant creditor is assisted in showing this by the statutory demand procedure. This enables a creditor to issue a demand on the company requiring it to pay the amount with in the time specified.

If the company does not pay or otherwise reach agreement with the creditor, the creditor may apply to the court for the winding up. The failure to comply with the demand will create a presumption of insolvency, which the company will have to disprove if it wishes to prevent the order being made. There is much case law associated with the statutory demand process, and consequently legal assistance may be advisable in relation to its issue.

Voluntary liquidation

The other major form of liquidation is voluntary liquidation. The voluntary liquidation method as the name suggests rests upon the members (shareholders) themselves passing a special resolution that the company be wound up. To achieve this the following process must be undertaken:

1. The board must call the meeting of shareholders and propose a special resolution that the company be wound up. This meeting must also appoint a person to act as the liquidator. The notice requirements for such a resolution must be complied with

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The basics

Liquidation can be described as the following procedure:

1. An independent liquidator is appointed to control the company
2. The liquidator gathers in all the assets of the company and realises their value (The term winding up is also used to describe this process)
3. The liquidator then pays out the liabilities of the company to the extent possible
4. If there are any funds remaining after the external liabilities are paid, the surplus is returned to the members according to the company's constitution
5. Once this process is complete the company will be deregistered and will cease to exist as a separate entity.

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2. The only exception to this requirement is where there has been a voluntary administration. In that situation the creditors may decide to place the company in voluntary liquidation
3. When the company is insolvent, the liquidator appointed must arrange for a meeting of the creditors to be held within a period of 11 days after the members meeting. At this meeting, the creditors may replace the liquidator chosen by the members
4. The directors must also provide financial information to the liquidator within seven days after the members' meeting.

Liquidators must be registered with ASIC and in the case of an appointment by the court must be registered as an official liquidator. Liquidators must also be independent of the various stakeholders in the company.

'The liquidator may also recover property paid out of the company before the liquidation commences by way of avoidance procedures.'

Operation of the liquidation

Both voluntary and court ordered liquidations operate in a similar manner. Once appointed the liquidator effectively takes over the running of the company to the extent required to close it down. The directors have obligations to assist and the liquidator has powers of examination of persons with information about the company.

All actions against the company are stayed unless approval of the court is obtained and shareholders cannot transfer shares. Creditors cannot enforce their rights against company property. The liquidator can disclaim property that is onerous. The liquidator is entitled to all of the property of the company at the time of the liquidation plus any property that is subsequently obtained. The property that is subject to a charge or other type of security is not available, however, until that debt has been satisfied. The liquidator may also recover property paid out of the company before the liquidation commences by way of avoidance procedures. There may also be claims against individuals or others based on insolvent trading or other breaches of the Corporations Act.

Where there is money available and in order to be paid, creditors must establish their claim with the liquidator- known as proving the debt. There are appeal rights to the court if a creditor is unhappy with the outcome. The liquidator makes payments to creditors on the basis that all are entitled to share equally in the funds available but the Corporations Act sets out a number of exceptions to this. These are largely concerned with two broad categories: the costs and expenses of the winding up, and the employee entitlements. If there are insufficient funds available to pay employee entitlements the liquidator may apply to the Government under the General Employee Entitlements and Redundancy Scheme (GEERS) to have the government pay the amounts and be substituted for the employee creditors.

At the end of the liquidation process, there is a further step of deregistration with ASIC, which ends the company as a separate legal entity.

For more information, guidance and tools on the global economic downturn refer to **charteredaccountants.com.au/news_issues/global_economic_downturn**

About the author

Colin Anderson CA is currently Associate Professor at the School of Law, Queensland University of Technology where he teaches insolvency law. Colin has over fifteen years experience in teaching insolvency law at undergraduate and post graduate level. For several years Colin was team leader of units used by the Insolvency Practitioners Association of Australia. Along with the Institute, Colin is a member of the American Bankruptcy Institute, INSOL International and is a Fellow of the Taxation Institute of Australia.

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