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# CREDIT ISSUES

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## WOODGATE & CO.

Chartered Accountant

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### VA or CVL

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#### Introduction

Since its introduction in 1993, voluntary administration ("VA") pursuant to Part 5.3A of the *Corporations Act* has been the quickest and the cheapest way for company directors to effect an insolvency administration.

However, the changes contained in the *Corporations Amendment (Insolvency) Act 2007* have streamlined the creditors' voluntary liquidation process ("CVL"). Under the new regime, a CVL will usually be as quick to initiate as voluntary administration and in many cases, cheaper.

Does this mean that directors who suspect that their company may be insolvent should prefer a creditors' voluntary liquidation to a voluntary administration?

#### The need for speed

There are two main reasons why company directors should act promptly to put an insolvent company into voluntary administration or liquidation.

The first is to deal with director penalty notices issued by the Australian Taxation Office pursuant to Section 222AOE of the *Income Tax Act 1936*

Director penalty notices aim to recover from directors certain taxation debts owed by companies. So that the director can avoid personal liability, a company has 14 days from receipt of the notice to pay the debt in full, negotiate a payment schedule, arrange for the company to be wound up or alternatively to appoint a Voluntary Administrator. If the company, or more to the point the director, does nothing, the director is personally liable for the amount of the debt recorded in the notice. Directors should be aware that because a Receiver and Manager or Managing Controller has been appointed by a secured creditor, or a Provisional Liquidator has been appointed, they are not relieved of the need to deal with the notice.

The second reason is to stop trading whilst insolvent. Directors may be made personally liable for debts incurred when their company is insolvent, pursuant to Section 588G of the *Corporations Act*. Well advised directors will act to place a company into voluntary administration or liquidation, as soon as they have reason to suspect that the company may be insolvent, unless the company is able to continue trading without incurring further debts. In most cases, this is impossible.

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Voluntary administration is initiated by the company executing a notice of appointment, following a directors' resolution that the company is insolvent or about to become insolvent and that it should appoint an Administrator. An appointment can occur within hours. There is no need for an application to be made to a Court to effect an appointment. Voluntary Administration is therefore quick and cheap to implement.

Although a CVL does not involve an application to a Court, the *Corporations Act* prior to 31 December 2007 specified at least seven days notice be given (in practical terms this is usually 11 days) by post for the meeting of creditors. The meeting of members which wound up the company could be held no earlier than the day before the meeting of creditors. This meant that it was unlikely that a company would be in liquidation within the 14 days required by Section 222AOE, particularly if the directors were slow off the mark.

Australian Securities and Investments Commission records stated that during the period from 1 January 2007 to 31 December 2007 2,443 voluntary administrations were effected. However, only 564 Deed of Company Arrangements were executed in the same period. Leaving aside the unusual event of a voluntary administration ending because the company is solvent, this suggests that 75% of voluntary administrations result in liquidation. The Explanatory Memorandum to the Corporations Amendment (Insolvency) Bill 2007 noted that many of the voluntary administrations that became liquidations were due to the director penalty notices being served on the directors or to deal with insolvent trading issues.

Until the reforms took effect on 31 December 2007, voluntary administration was often the only practical alternative for directors forced to make a quick insolvency administration appointment, even if there was no proposal for of a Deed of Company Arrangement.

### **The reforms**

*The Corporations Amendment (Insolvency) Act 2007* provides for numerous changes to insolvency administrations.

By allowing the creditors meeting to be held 11 days after a Liquidator has been appointed at the meeting of members, it will be possible for the company to be put into liquidation almost as quickly as placing the company into voluntary administration. This assumes that 95% of members consent to the meeting of members being held with less than 21 days notice, pursuant to Section 249H(2) of the Corporations Act. In most sole director/sole member companies or small privately owned companies, consents to short notice can be quickly obtained from the members.

This presents directors and their advisers with a new decision. Now that both voluntary administration and CVL can be implemented very quickly, how do you determine whether a voluntary administration or a CVL is most appropriate in the circumstances of the company?

### **The case for CVLs**

A voluntary administration involves two meeting of creditors, requires the Administrator to investigate the company's affairs, report to creditors and make specific recommendations to creditors about whether:

- the company should execute a proposal for Deed of Company Arrangement;
- the administration should end; or,
- the company be wound up.

This process applies regardless of winding up being the inevitable outcome for the company. It is a cost to the insolvent company and hence its creditors.

With a CVL there is no need for an upfront investigation and the report to creditors. Usually, there is only one meeting of creditors. This means that a CVL is a lower cost alternative, which is particularly relevant to directors who are asked to pay the costs of the insolvency administration, if the company is assetless.

### **The case for Voluntary Administration**

The significant advantage of voluntary administration is the moratorium on recovery action by certain creditors.

A voluntary administration suspends any recovery action by creditors, except with permission of the Court or the Administrator in respect of:

- leased and hired equipment, which cannot be repossessed;
- stock, subject to retention of title and consignment, which cannot be removed;
- landlords who cannot require the company to vacate its leasehold premises due to a default under the lease; and,
- secured lenders which cannot enforce their security (except in limited circumstances).

If there are physical assets to be realised such as stock, plant and

equipment, the voluntary administration process is very useful. For one, the landlord is restricted from taking possession of the insolvent company's leasehold premises and locking it out. Further, the Administrator is empowered to sell stock subject to retention of title ("ROT") in the ordinary course of the business; but must account to the ROT creditors. Stock can be sold to generate a gross profit; a benefit to the company. VA may enable the Administrator to realise plant and equipment in situ rather than removing it to an auctioneer's premises.

### **Conclusion**

A CVL is an option for a company, if liquidation is inevitable and there is no business to protect or physical assets to realise.

The number of companies entering voluntary administration simply to protect the directors from the effects of directors' penalty notices or insolvent trading are expected to drop and a corresponding increase in the number of CVLs is also expected.

However, for companies with ongoing operations or physical assets to be protected and realised, a voluntary administration is likely to be the most appropriate option.

Directors who receive director penalty notices or who suspect that their company may be insolvent must act promptly. Greater choice means that it is more important than ever to consult specialists to obtain specific advice which addresses the individual circumstances of the company.

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