

Personal Insolvency

Bankruptcy

A person may be declared bankrupt either by his or her own petition, or as a result of a petition presented by a creditor to the Court.

A creditors petition is presented to the Court and if accepted the Court will issue a Sequestration Order. The costs of the creditors petition are given priority and the commencement date of bankruptcy has an extended relation back date.

A debtors petition is presented to ITSA and upon its acceptance by the Official Receiver the debtor is made bankrupt.

The Official Receiver is appointed trustee unless a consent is lodged by a Registered Trustee.

All divisible property of the bankrupt vests in the trustee and there are a number of restrictions placed on the bankrupt as a consequence of the appointment of a trustee.

A bankrupt is typically bankrupt for a period of 3 years from the date of the lodgement of that State of Affairs although this period may be extended where the trustee considers the grounds for an objection to occur. An objection can extend the bankruptcy to 5 or 8 years.

Compositions or Arrangements with Creditors

The bankrupt may offer a post bankruptcy compromise to creditors and if accepted by creditors it has the effect of an annulment of the bankruptcy.

The terms of the compromise may vary and the trustee is required upon completion of his or her investigation to report on the proposal for creditors to assess whether to accept the compromise or not.

Appointment of a Receiver under the Bankruptcy Act

Where creditors are concerned as to the disposition of business assets or other specific assets pending the Court hearing of a creditors petition; creditors may seek the appointment of a Receiver to take control of those assets subject to further Orders from the Court.

Debt Arrangement

This is an alternative to Bankruptcy and Part X Arrangements. You can propose a debt arrangement if you meet certain tests which are:

- You have not been a bankrupt, used the debt agreement system or given an authority under Part X of the Bankruptcy Act in the last ten (10) years.
- Your unsecured liabilities are less than the amount prescribed from time to time pursuant to the Bankruptcy Act.
- Your after tax income is less than the amount prescribed from time to time pursuant to the Bankruptcy Act.

Personal Insolvency Agreement "PIA"

As an alternative to Bankruptcy, the insolvent debtor may elect to have his or her estate subject to the control of a Trustee, pursuant to an agreement with creditors referred to as a Personal Insolvency Agreement ("PIA"). The PIA is a very flexible arrangement with creditors whereby creditors may agree, (but not be limited) to any of, or a combination of the following examples:-

- Antecedent transactions may or may not apply.
- Basis of termination of the PIA.
- Extent debtor released from provable debts

- Future income contributions may or may not apply.
- The debtor may agree to pay creditors a guaranteed dividend to all creditors or to a different class of creditor.
- Where the debtor is required to pay to the Trustee an agreed sum for distribution to the creditors in full and final settlement of creditors' claims and the order of payment to creditors.
- Where the insolvent debtor assigns all of his or her assets to a Trustee who then realizes them and distributes the proceeds to creditors.
- Where the Trustee is empowered to deal with the assets and future income of the insolvent debtor for the benefit of creditors in terms of the provisions of the PIA.

PATTISONS provides advice on:

- Business Restructuring
- Company Restructuring
- Corporate Insolvency
- Credit Control Procedures
- Creditors Meeting
- Creditors Rights
- Debt Recovery
- Debt Security
- Dispute Resolution
- Forensic Accounting
- Insolvency Administrations
- Litigation Support
- Personal Insolvency
- Pre Lending Reviews
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INSOLVENCY

Insolvency may be defined as "the ability of a company or individual to pay their debts as they fall legally due from their own money"

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BUSINESS ADVISORS & INSOLVENCY SPECIALISTS

SUMMARY OF THE LAW

Solvency

A company or a person is solvent if the entity is able to pay its debts, as and when they become due and payable.

Insolvency

In determining solvency a debtor is not limited to cash resources and the Courts will take into account what the debtor can procure by realising assets within a relatively short time [Sandell v Porter (1966) 115 CLR, 666, 40 ALJR7].

The Courts have confirmed that the entirety of the debtor's financial position has to be considered.

"A temporary lack of liquidity does not necessarily mean insolvency".

A company is not bound to keep sufficient cash resources on hand to meet all outstanding indebtedness. [Bank of Australia v Hall (1907) 4CLR1514, 1543].

In Hymix Concrete Pty Ltd v Garrity [(1977) 13ALR 321,328] Jacobs J said "A temporary lack of liquidity must be distinguished from an endemic shortage of working capital whereby liquidity can only be restored by a successful outcome of business ventures in which the existing working capital can be deployed".

In the matter of William Gary Quick v Stoland Pty Ltd [(1988) 87 FCR 371], The Full Court made the following observation: "A deficiency of total assets to total liabilities is not conclusive as to insolvency. A company could have a deficiency of net assets yet, because of a very strong profit making business, be in a position to pay all of its debts as and when they become due and payable. That is to say that even if a net asset deficiency exists, reasonable projections may indicate that the company would generate sufficient profit to be able to eliminate that deficiency before the long term debt becomes due and payable. The company would be solvent in these circumstances. Equally, a company which has a surplus of total assets over total liabilities could still be insolvent".

Section 95A of the Corporations Act contains a definition of "Solvent", which indirectly provides a test of Commercial or Cash Flow insolvency. This section of the Act states that: "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".

Company Insolvency

In considering the question of insolvency there are two primary tests which are generally employed to determine whether a company is solvent. These tests are:

- Cash Flow Insolvency, or
- Balance Sheet Insolvency

Under the Cash Flow Insolvency test a company is regarded as being insolvent when it is unable to pay its debts as and when they become due and payable.

The Balance Sheet Insolvency test provides that a company is insolvent if the total liabilities exceed the value of its total assets.

A company might be considered insolvent because it failed the Cash Flow Insolvency test but have sufficient assets to satisfy the Balance Sheet Insolvency test. However, in these circumstances the company may be considered by the Courts to be solvent, subject to the company being able to realise sufficient assets to meet its cash flow requirements, within a reasonable period of time.

A company's debts may be satisfied from a cash flow point of view even though its total liabilities are greater than its total assets. In this case the company may be considered by the Courts to be insolvent.

Personal Insolvency

Under the Bankruptcy Act 1966 (Cth), a person is solvent if, and only if, the person is able to pay all of the person's debts, as and when they become due and payable.

COMMON INDICATORS OF INSOLVENCY

- Cheques being dishonoured
- Cheques being drawn in favour of creditors but not released for some time after the date of signing
- Cheques being drawn in favour of creditors which are post dated and sent out
- Cheques being drawn in favour of creditors that are signed but never sent out
- Cheques being paid to creditors in the nature of a rounded sum (not being an accepted industry practice) and the payment not being reconcilable to specific invoices
- Cheques received from customers being endorsed direct to creditors
- Creditors requests for payments being ignored
- Deficiency in working capital

- Directors entering into personal loan agreements with third parties in order to inject funds into a business which is unable to obtain further borrowings
- Directors channelling company receipts into their personal accounts and then paying creditors directly from those accounts
- Failure to forward money purported to be held in trust eg. PAYG, ITW, GST, super fund contributions, union dues etc.
- Increase in personal guarantees being given
- Increased creditor levels at a time when sales are reducing
- Increased purchases requiring cash on delivery for creditors who previously supplied on credit terms
- Involuntary reduction in facilities provided by bankers
- Poor liquidity
- Poor management
- Receipt of summonses in respect of legal action taken by creditors to pay accounts
- Requests from suppliers to return stock in lieu of payment of a debt outstanding
- Threatening letters from creditors to pay accounts
- Unprofitable trading

TYPES OF INSOLVENCY ADMINISTRATION

The commentary and advice provided in this brochure is of a general nature and should not be considered specific advice.

In considering the type of appointment and factors that may impact on your particular circumstances you should seek professional advice from Pattisons.

Pattisons are expert insolvency practitioners and experienced business advisors and welcome the opportunity to assist and advise you.

Corporate Insolvency

Members Voluntary Winding Up

In relation to a Members Voluntary Winding Up, the company is solvent.

To enable the process of a Members Voluntary Winding Up to occur, the directors must convene a meeting of the members with a view to having a Liquidator appointed.

A Liquidator appointed in a "Members Voluntary Winding Up" has a duty to realise the assets of a company, pay out all creditors and distribute the balance of the assets realised equitably amongst the shareholders (in accordance with the Memorandum & Articles of Association or Constitution), giving due regard to the rights conferred on the different classes of any shares or alternatively, distribute surplus assets to shareholders in specie.

Provisional Liquidation

This is a Court appointment where, a director, creditor or the Australian Securities and Investments Commission (ASIC) lodges a wind up petition against a company and the Court determines that the assets of the company are at risk pending the hearing of the petition.

In this appointment, the Court appoints a Provisional Liquidator to take control of the company's assets.

A Provisional Liquidator is a Registered Liquidator who has been specifically authorised by ASIC to act as an Official Liquidator to be appointed by the Court thereby being an Officer of the Court.

A Provisional Liquidator must act in accordance with the terms of the Court Order under which he or she is appointed.

A Provisional Liquidation appointment is terminated upon the withdrawal of a petition by the applicant or the Court or following the appointment of a Liquidator (Official Liquidator) by the Court.

Court Winding Up

In this form of administration, the Court appoints an Official Liquidator. This appointment generally follows the hearing of a petition by a Director, Shareholder or Creditor, who has claimed that the company is insolvent and is unable to pay its debts as and when they fall due, and accordingly, should be wound up. In some instances ASIC may also seek the appointment of an Official Liquidator.

Creditors Voluntary Winding Up

In this form of administration, the Directors have resolved that the Company is insolvent and accordingly, is unable to pay its debts.

The Directors convene separate meetings of the members and the creditors with the view to tabling a Report as to Affairs of the company prepared and signed by them.

After being appointed, the Liquidator is duty bound to realise the assets of the company at the best available values, bearing in mind that where at all possible, the Liquidator is to pay a dividend to the unsecured creditors to compensate them for any losses that they may have suffered.

Receiver

A Receiver or Receiver and Manager is appointed where a company has defaulted under the terms of a fixed or floating charge, Debenture or Mortgage.

The secured creditor has seen it appropriate to appoint an independent person to act on its behalf in the recovery of its debt.

Where a Receiver is appointed by a secured creditor, the appointment is made under a fixed charge or Debenture.

A Receiver has the power to take control of specific assets of the company, in accordance with the terms of the fixed charge or Debenture, to enable the secured creditor to be repaid.

Where a Receiver is appointed by the Court, the Receiver must act within the terms of the Court Order under which he or she is appointed.

Receiver Acting Under the Terms of the Mortgage

A Receiver may act on behalf of a Mortgagee in relation to a real property mortgage, fixed mortgage or specific mortgage. The Receiver's powers are limited to the terms of that mortgage document.

Receiver and Manager

A Receiver and Manager has the power to trade on the business by assuming control of the company's assets.

A secured creditor may appoint a Receiver and Manager pursuant to a fixed and floating charge or Debenture.

The Receiver and Manager proceeds to realise those assets, the subject of the charge at the best available values with an aim to pay out the secured creditor in full, and that where possible, enable a surplus of assets if any, to be returned to the company to be distributed amongst unsecured creditors in the order of payment as prescribed in the Corporations Act.

A Receiver and Manager is personally liable for authorised debts incurred during the course of the administration.

Agent for the Mortgagee in Possession

A person may be appointed to act as an Agent for the Mortgagee who has taken possession of property by which the Mortgage is secured.

In this administration the Agent's power is limited to the terms of the mortgage document.

Controller

A Controller is defined as a Receiver or Receiver and Manager of that property, or anyone else who (whether or not as an agent for the Corporation) is in possession, or has control, of that property for the purpose of enforcing a charge.

Managing Controller

A Managing Controller is defined as a Receiver and Manager of that property, or any other Controller of that property who has functions or powers in connection with managing the Corporation.

Scheme of Arrangement

A Scheme of Arrangement is a Court approved arrangement between the company, its shareholders and its creditors.

This form of administration occurs where the Directors seek the approval of the Courts to enter into an arrangement with the company's creditors in order to enable the company to trade on.

Voluntary Administrations and Deeds of Company Arrangement

The objective of a Voluntary Administration is to provide a mechanism to rehabilitate the company whilst creditors' claims are frozen; to maximise the opportunity for the business to continue to operate and/or to maximise the return to creditors, that may not have been available in an immediate winding up of the company.

The Administrator may be appointed by resolution of the Directors or by a Liquidator or Provisional Liquidator or secured creditor. An Administrator is personally liable for authorised debts incurred during the course of the administration.

This is achieved by the company executing a Deed of Company Arrangement (DOCA). The DOCA proposed is approved by creditors and can be very flexible in its terms in order to achieve the rehabilitation of the company. Creditors in accepting a DOCA should always be mindful that the proposal incorporates strategies that address the reasons for the insolvency of the company in the first instance.

Expertise

Insolvency

Professional Advice

Support