ON THE BEAM

CONDON
FORENSIC INSOLVENCY TURNAROUND
ASSOCIATES

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Understanding Provisional Liquidation Section 472(3), Corporations Act 2001

By Ashley

Provisional Liquidation is one tool available to various stakeholders to either arrest the dilution of a company's assets or rectify problems concerning the control and/or management of a company.

Provisional Liquidation concerns the appointment of a liquidator to a company by orders made in court, generally immediately following the filing of an application to wind a company up. By its nature, it is provisional as it covers the period between the lodging of an application to wind the company up and the court hearing the winding up application.

In considering making orders appointing a provisional liquidator, a court will consider in the first instance the "flight risk" of a company's property - the question as to the company's solvency is considered at the hearing of the winding up application: in ASIC vs Solomon [1996], the court held that "the court should only appoint a provisional liquidator where it is satisfied that there is a valid and duly authorised winding up application and that there is a reasonable prospect that a winding up order will be made".

Section 462 of the Corporations Act 2001 provides that the parties entitled to seek relief for the appointment of a provisional liquidation includes the company's members, directors and creditors. The regulatory bodies such as ASIC and APRA can also be heard in such applications.

Only Official Liquidators can be appointed as provisional liquidators and their powers are fixed by orders made by the Court and the Act – a provisional liquidator will neither distribute any of the company's property nor inspect a company's books.

A provisional liquidation is generally terminated by an order of the Court in the proceedings in which it was commenced. At this time, control of the company is either returned to the directors or the company is placed into liquidation.

Condon Update

By Lyn Dong

Some exciting news!

The 2016 RAA Association and Condon Associates Group Charity Golf Day is coming! So, save the date for Thursday 4 August 2016 and watch this space for more updates. Sponsorship opportunities available, please contact us for more details on (02) 9893 9499 or email events@condon.com.au.

We are very proud to have hosted the Parramatta Chamber Business After Five on our balcony on 10 November 2015. The event offered an exclusive and unique view of this beautiful ever-changing growing Parramatta.

Don't forget the Parramatta Accountants Discussion Group meetings resume from February. The upcoming meeting will be held on Monday 8 February. For more information and registration, please visit http://www.thecondongroup.com.au/upcoming-events/

Here are some Kodak Moments…

Local business operators and professionals gathered at the November Business After Five.

The team at Condon Associates Group look forward to assist you and your clients with the quality specialist support.

Bankruptcy in a Year, Liquidation in a Month; Here's to 2016!

By Schon G Condon RFD

Well what a way for 2015 to finish. Everyone was flat out, windings up remained high, the ATO stance has not waned, oil prices are down, the market ends almost where it started and the issue of the need to continue to boost the future of our economy again cycles to the forefront; but this time with the suggestion that a 12 month period of Bankruptcy will be the cure all!

It is interesting to note that originally, the period of three years was actually set in Roman times by the Roman Senate when they introduced laws dealing with the inability of individuals to pay their debts and it has essentially remained so ever since. At that time the process of law making was potentially very similar to the way it is now, but the communication and data access available to the then common man (well let's get real, anyone actually!) was very different to the modern day. So why is this relevant do I hear you say?

Well I'm not sure that simply changing the period of Bankruptcy will actually have any real effect other than maybe more will go bankrupt, they may do it for less and life as a whole will not change. Let's have a look at some issues that are far more likely to have a far greater impact, if that's what we really want to achieve.

Firstly, in one matter we did some years ago a director faced financial troubles with his business due to a downturn in trade and some bad debts, and as a result worked to implement a Deed of Company Arrangement to fix the problem. There was a bank involved with security over the whole of the business (and the family home) in respect of its $150,000 overdraft and they were kept fully aware of the process and its result all the way through. However, as per normal they sought to maintain a "non-involvement" stance. Nonetheless the proposal was ultimately accepted by Creditors and life moved on; the business began to recover.

Approximately seven months later the bank made a policy decision not to support ANY customer who had previously had ANY involvement with ANY insolvency legislation. Thus the businesses overdraft was closed, and the Bank sought to recover both the business and home loan debts predominantly from the Director's home. The business, which was still on "the-improve" at the time, collapsed leaving many Creditors even deeper in debt than where they had been in the first place. The assets were realised and went to pay the bank and costs. The bank realised the house and recovered, including costs, in full. The balance went to pay a couple of secured trade debts as a partial reduction of those debts. The Director and his wife went bankrupt. Clearly what is needed here is some sort of law that says you can't change your mind if it has serious financial consequences for others!

Inside this issue:

- Rights of Secured Creditors in a DOCA Situation
- Recovering a Trustee's Costs When a Sequestration Order is Set Aside
- Understanding Provisional Liquidation *Section 472(3), Corporations Act 2001*

Secondly, one of the most common problems we face with Bankrupts for many years after their bankruptcy is their Credit Reports. Now under that part of the system the law allows the detail to remain for a period of seven (7) years! Not three! (Even better the internet can make it last forever!) Another issue is that it's all there; even if you end up paying your creditors in full you remain tagged for seven years! I know because I've had discharged Bankrupts yelling at me about the irresponsibility of the actions that are taken against them years later. As far as they are concerned, it's MY fault. The system is simply absolute, it provides no allowance for anyone that endeavours to make any effort to do the right thing.

Thus it really doesn't matter how long you're Bankrupt because the databases will make sure it's never forgotten. Maybe we should have a law to more effectively manage the public management of data?

Thirdly, we don't let someone onto the road in a car until that person has demonstrated that they are proficient in driving the vehicle. That way hopefully they won't kill someone or alternatively cost someone to lose massively financially due to

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reckless damage done by an untrained driver. Believe it or not in some cases licences can take years to get and even some people actually never pass the test.

So why is it that we can unleash someone into business with absolutely no training; you only need to be breathing to buy a company! Regrettably often there is a lot of damage done to themselves and their families that is often not fully accounted for. Yes, regrettably, I have come back to a matter in the morning only to find that the Debtor/Director had committed suicide overnight. Maybe what we need is a law that ensures people are properly prepared for what they are about to do in business.

Fourthly, and well maybe fifthly and sixthly and so forth, there are a number of issues that we need to fully consider, the removal of guillotine clauses, processes that seek the preservation of value over mindless administrative process, a genuine acceptance of an appropriate level of risk by all and a Court system that accepts and understands all of this and is capable of resolving issues economically and in a timely manner.

So where am I? I have seen some people who simply never learn, and here I would seriously say that gambling is a disease; it accounts for my most significant repeat offenders, the shorter duration will simply mean they are back sooner. On the other hand though, I have seen a number of people come through the process and go on to lead very successful lives. The difference?

Well it's not the time they served but the fact that they learnt lessons, acted honestly, worked hard, paid what they could when they had to, did not put others down, focused on what they had and could build not what they need to be better than their neighbour, and maintained a positive, even if dented, vision of the future.

If someone thinks they can achieve all of this for someone by merely reducing the period of Bankruptcy by two years they have rocks in their head; but then, it might just save some administrative cost somewhere in the system.

Let's all have a great 2016!

Rights of Secured Creditors in a DOCA Situation

By Hiteshi Dekhtawala

In a recent Supreme Court of NSW decision, *Bluenergy Group Ltd (Subject to a Deed of Company Arrangement) (Administrator Appointed) [2015] NSWSC 977*, Justice Black adopted a very practical approach in dealing with the legitimacy of the appointment of a voluntary administrator by a secured creditor whilst Bluenergy was still subject to the Deed of Company Arrangement ("DOCA").

Bluenergy was placed into voluntary administration and subsequently entered into a DOCA, resulting in the extinguishment of all creditors' claims at the commencement of the administration. One of the Secured Creditors, Keybridge, had abstained from voting on the deed proposal and subsequently appointed a second voluntary administrator relying on section 444D(2) of the Corporations Act 2001 (Act), which allows a secured creditor to realise or otherwise deal with its security interest where they had not voted in favour of the proposal.

The appointment of the second administrator was questioned by the existing deed administrator on the grounds that as Keybridge had not voted against the proposal, it was bound by the terms of the DOCA. As a result of this, Keybridge had no debt owed to it and as such had lost the ability to appoint the second administrator.

Keybridge argued that as section 444D(2) preserved the rights of a secured creditor, it automatically preserved the debt owed to the secured creditor and accordingly, the appointment of the second administrator was valid.

In his decision, Justice Black noted that the purpose of Part 5.3A of the Act was to allow a fresh start to companies with a prospective future. Justice Black made orders encompassing that:

- The debt to Keybridge had extinguished due to the terms of the DOCA and as such Keybridge ceased to be a creditor of Bluenergy.
- Due to the operation of section 444D(2), Keybridge's proprietary interest in the property prevailed and therefore, it possessed the right to realise its security.
- Relief be granted under section 447A of the Act to end the second administration on the grounds that there was no utility in the process i.e. the second administrator's appointment did not meet the objectives of Part 5.3A of the Act.

The above decision has serious implications for secured creditors:

- Although their security rights are preserved, they can only be exercised on the assets existing at the time of the administration and do not extend to include any after-acquired property; and
- The only recourse available to the secured creditors would be to enforce their security rights over a company's property as soon as the security crystallises i.e. at the date of voluntary administration. Alternatively, secured creditors should pay close attention to the formulation of a DOCA and consider being actively involved in negotiating its terms, to ensure their rights remain intact, even to the extent of any after acquired property of the company.

It is the writer's view that the active involvement of secured creditors in negotiating the terms of a DOCA may result in a higher success rate of DOCAs and the resurrection of companies, as intended by Part 5.3A of the Act.

Recovering a Trustee's Costs When a Sequestration Order is Set Aside

By James McPherson

A bankruptcy trustee's prospects of recovering his or her costs, incurred in the early stages of an administration where a sequestration order has ultimately been set aside, have been considered in recent judgments handed down in the Federal Court of Australia.

Sequestration orders against the estate of a debtor are commonly made by a Registrar (in lieu of a judge) exercising a judicial power, on a petition presented by a creditor, where the Registrar is satisfied as to the basis of matters on which the petition is presented.[1] A debtor then has a period of 21 days to seek a "*judicial review*" of the Registrar's making of the sequestration order.[2]

Once the sequestration order is made, the petitioning creditor must provide a copy of the order to the Official Receiver within two days beginning on the day the orders was made.[3] Following their appointment, a trustee be it a registered trustee or the Official Trustee, has certain statutory tasks and duties to perform, including taking steps to locate, identify and protect the bankrupt's divisible property.

A trustee's charges and expenses, incurred in administering a bankrupt estate, are granted a priority under the Act and are generally recovered from the proceeds of a bankrupt's property.[4]

Section 153B of the Bankruptcy Act provides that the Court may make orders annulling a bankruptcy where it is satisfied that a sequestration order ought not to have been made or a debtor's petition should not have accepted by the Official Receiver. With regard to settling the trustee's expenses and charges incurred up to the time when such orders are made, section 154(1)(b) of the Act provides that the "*trustee may apply the property of the former bankrupt still vested in the trustee*".

Where the bankrupt makes an application for a judicial review of the making of a sequestration order and the Judge finds that the Registrar erred when exercising a judicial power, the Judge will normally set aside the sequestration order and in turn, the Official Receiver will remove the record of the sequestration order and creditor's petition from the National Personal Insolvency Index.

In most cases, the Judge will find that the debtor should not be burdened with the cost of the trustee's remuneration and expenses in which case, the trustee misses out.

So the decision by a Court to either set aside a sequestration order or annul the bankruptcy is critical to the trustee's chances of being paid for their efforts in administering the estate for the short period. This issue and the issue of a trustee's statutory priority for costs were considered by Justice Weinberg in *Kyriackou v Shield Mercantile Pty Ltd (No 2)*[5].

The Official Trustee, the respondent in the proceedings, submitted to His Honour that it would be more appropriate to annul the bankruptcy in lieu of setting aside the sequestration because he was entitled to be recompensed for the costs and expenses incurred in undertaking his statutory obligations and responsibilities in administering the estate. Furthermore, setting aside the sequestration order would deny him the statutory protection provided by section 154 to recover his expenses and charges.

Weinberg J acknowledged the Official Trustee's "*legitimate sense of grievance*" to be left "out of pocket" however, added that it would also be wrong to burden the successful appellant "*with the costs of administering a bankrupt estate that should never have been made the subject of a sequestration order*". Weinberg J observed that the "*bankruptcy notice failed to meet a requirement made essential by the [Act]*" and accordingly, the sequestration order ought to be set aside.

The resultant outcome for costs in the *Kyriakcou*[6] matter was that the petitioning creditor bore the debtor's costs of litigation and the expenses and charges arising from the bankruptcy period were left with the Official Trustee to pursue, under whatever remedies were available.

The *Kyriakcou*[7] decision was referred to in *Flint v Richard Busuttil & Co Pty Limited* [2013] by the full Federal Court. In this case, whilst the sequestration order was set aside, the registered trustee successfully argued that it would be would be a gross injustice if he was not recompensed for administering the estate.

Accordingly, the trustee was entitled to take 75% of his remuneration from Ms Flint's share of the net sale proceeds on the basis that whilst she was solvent at all times, she ignored the petitioning creditor and then failed to appeal the sequestration order within the 21 day period.

The petitioning creditor was required to meet the remaining 25% of the trustee's remuneration with the Court finding no fault with the trustee's conduct in the matter.

The cautionary note for trustees is to proceed with a light touch in new bankruptcy administrations during the 21 day period following the making of sequestration orders, lest the orders are challenged and especially where the sequestration order was made by a Registrar.

1 Sections 43 & 52, Bankruptcy Act 1966
2 Section 52(3), Bankruptcy Act 1966
3 Section 52(1A), Bankruptcy Act 1966
4 Section 109, Bankruptcy Act 1966
5 [2004] FCA 1338
6 Kyriackou v Shield Mercantile Pty Ltd (No 2) [2004]
7 Kyriackou v Shield Mercantile Pty Ltd (No 2) [2004]