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## NATIONAL REPORT FOR AUSTRALIA

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### A. Introduction

#### 1.1 Historical development and current insolvency regime

The English Bankruptcy Act of 1542 and subsequent 17th century legislation served as the model for early personal insolvency laws upon white settlement in Australia. In 1840 the colony of New South Wales, Australia's first colony, passed an Absent Debtors Act and the following year an Act for Giving Relief of Insolvent Debtors. A number of the colonies passed insolvency legislation in the period leading up to Federation in 1901. Under the Australian Constitution from 1901 the Federal Parliament has had power to 'make laws for the peace, order and good government' with respect to bankruptcy and insolvency. The Federal Parliament used this power in 1914 to create its first Bankruptcy Act and there were new Acts in 1924 and 1966. The present legislation is the Bankruptcy Act 1966 (Cth) which had major amendments in 2002 and 2004.<sup>1</sup>

The creation of joint stock companies legislation in England in 1844 and its subsequent Winding Up Act of 1844 saw the law and practice of bankruptcy extended to apply to companies. Colonial Australia followed the English and the colony of New South Wales passed a Winding Up Act in 1847. Company legislation was further developed in England in 1856 and 1862. All Australian colonies followed the English lead and put corporate insolvency within their companies legislation. Queensland introduced corporate insolvency as part of its corporate legislation in 1863, Victoria and South Australia in 1864, Tasmania in 1869, New South Wales in 1874 and Western Australia in 1893. Upon Federation in 1901 the colonies became states and each had power to legislate for companies. The states updated their companies' legislation after Federation at various times and all but one state changed their legislation to reflect changes made in the Companies Act 1929 (UK). In 1961 there was some diversity amongst the different state legislation and the state governments attempted a Uniform Companies Act to gain uniformity. After some creeping diversity another such move was made in 1981 when a Companies Code applied across Australia and again in 1991 further uniformity was achieved using 'template' legislation where each state enacted legislation identical to the others. This was known as the Corporations Law. After substantial debate and court challenges, the states agreed to refer their powers of corporate lawmaking

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<sup>1</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 4–5.

to the Federal Parliament. Since 2001 there has been one corporate piece of legislation (incorporating into it the corporate insolvency law) and it is known as the Corporations Act 2001 (Cth).<sup>2</sup>

The most comprehensive reform of insolvency law came with the release of the Australian Law Reform Commission's Report No. 45 in 1988.<sup>3</sup> This report is known as the Harmer Report. Again it could be said that Australia followed England and its Cork Committee and its resultant Report that was delivered in 1982.<sup>4</sup> The Harmer Report acted as a stimulus for reform introduced in 1993 and still serves as an important starting point in any discussion when insolvency laws and their reform are considered.

In 2008 Australia passed legislation that adopted the UNCITRAL Model Law. The Model Law has force of law in Australia with certain modifications.<sup>5</sup> The Federal Court of Australia has jurisdiction for matters of cross-border bankruptcy while that court and the state supreme courts have jurisdiction for cross-border corporate insolvency matters.<sup>6</sup>

## 1.2 Purposes of insolvency proceedings

The fundamental features of Australian insolvency law are that it is based on collective, compulsory and equalising processes.

For liquidations there is no express purposes found in the legislation. However, it is understood that the liquidator will work for the best outcome for creditors, maximising their dividend from the insolvent estate. For the most part the creditors' proven debts and claims rank equally and if the property of the company is insufficient to meet them in full then they must be paid proportionately.<sup>7</sup>

Where the administration, that is corporate rescue, provisions have been added to the corporate law statute there is an 'objects' section that provides that the object

is to provide for the business, property and affairs of an insolvent company to be administered in a way that [either] maximise the chances of the company, or as much as possible of its business, continuing in existence; or if it is not possible for the company or its business to continue in existence – [then] results in a better return for the company's creditors and members than would result from an immediate winding up of the company.<sup>8</sup>

When this corporate rescue law was proposed other purposes were mentioned such as the preservation of employment but these did not make it into the final 'objects' section.<sup>9</sup>

There is not a strong informal restructure or workout culture in Australia due to the high risk for breaches of insolvent trading laws upon directors. Furthermore the laws of unfair preferences protect creditors who are excluded from any informal process and this would mean that any informal workout failure would see participant creditors being asked to repay

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<sup>2</sup> *Ibid.*, 5.

<sup>3</sup> ALRC Report No. 45; General Insolvency Inquiry (AGPS, Canberra, 1988) Chair Ronald W Harmer known as the Harmer Report.

<sup>4</sup> Report of the Review Committee, Insolvency Law and Practice (Review Committee, London, 1982, Cmmd 8558) Chair Sir Kenneth Cork known as the Cork Report.

<sup>5</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 363.

<sup>6</sup> Cross Border Insolvency Act 2008 (Cth) ss. 10, 19(5).

<sup>7</sup> Corporations Act 2001 (Cth) s. 555.

<sup>8</sup> Corporations Act 2001 (Cth) s. 435A.

<sup>9</sup> Australian Law Reform Commission Report No. 45, Harmer Report, para. 52.

their advantage. It is also said that the ease of commencing receivership for secured creditors, voluntary administration for directors and liquidation for other creditors means that informal work outs are rare.<sup>10</sup>

Where informal work outs do take place they are usually confidential between the parties, most likely a financier and the debtor company. They are not subjected to any special regulation and the general laws of contract apply. If a financier did support an informal work out with further finance and security these late charges can be void against a liquidator should the company still fail.<sup>11</sup>

For bankruptcy again there is no specific provision outlining the 'purposes' and case law suggests that the proceedings should relieve the debtor from liability for their debts, that is a fresh start.<sup>12</sup> Here, too, the *pari passu* doctrine is important. The Bankruptcy Act 1966 (Cth) provides that, subject to the Act, all proven debts rank equally and if the proceeds of the property of the bankrupt are insufficient to meet these debts in full then they will be paid proportionately.<sup>13</sup>

There is no established concord to turn to in establishing the aims of insolvency in Australia. In addition to those purposes mentioned above, the following list surveys those aims essential for good insolvency law and practice that can be found as features of Australian law; (1) a fair and orderly process (2) with both debtor and creditor participation, (3) having procedures that promote impartiality, efficiency and expedition, and (4) providing laws that assist in the convenience of property recovery and prevent fraudulent conduct, and (5) that support the commercial and economic processes of the community including providing penalties for breach of statutory provisions, and (6) that harmonises with other laws. Added to this list is the international dimension as Australia has adopted an UNCITRAL Model on Cross-Border Insolvency and the further aim to restrict directors' roles and powers during insolvency and provide a mechanism to remove directors from the management of companies (and the future management of companies) where they have been found to have been involved with the failure of a number of companies. Finally, there is the aim of providing a body of honest insolvency practitioners.<sup>14</sup>

To date in Australia societal interests such as preservation of employment or environmental interests do not feature in the statutory laws of insolvency and there is not case law that provides clear direction that such interests take precedence.

In liquidation a liquidator can also carry on and sell the company's business as a going concern<sup>15</sup> but could not reorganise the company as liquidator although he or she could commence an administration (corporate rescue).<sup>16</sup> The company can present to creditors a creditors' scheme of arrangement under the Corporations Act 2001 (Cth) which would

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<sup>10</sup> Lampros Vassiliou, *The Dynamic Between the Role of Court and the Informal Workouts* paper presented to Forum of Asian Insolvency Reform, Bali, Indonesia, 7–8 February 2001.

<sup>11</sup> Corporations Act 2001 (Cth) ss. 588FA, 588FJ.

<sup>12</sup> *Le Mesurier v Connor* (1929) 42 CLR 481.

<sup>13</sup> Bankruptcy Act 1966 (Cth) s. 108.

<sup>14</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 6–9.

<sup>15</sup> Corporations Act 2001 (Cth) ss. 477(1)(a), 477(2)(c).

<sup>16</sup> Corporations Act 2001 (Cth) s. 436B.

propose reorganisation although these are rarely used given the cost and court involvement and the existence of a dedicated corporate rescue regime.<sup>17</sup>

As observed above the 1993 Corporations Act amendments provided for a statutory scheme of corporate rescue (administration) and for the administrator to have power to sell the company's business as a going concern and achieve a reorganisation.<sup>18</sup>

In bankruptcy a trustee in bankruptcy is permitted to carry on and sell the bankrupt's business so far as it is necessary in the winding-up of the estate to benefit creditors.<sup>19</sup>

## **B. The types of insolvency proceedings**

### **1.3 Types of insolvency proceedings available to general business debtors and their main characteristics**

In Australia corporate insolvency proceedings include liquidation (known as winding-up), reorganisation termed administration (including voluntary administration and deed administration)<sup>20</sup> and receivership,<sup>21</sup> which is used by the secured creditor. In personal insolvency there is formal bankruptcy and two alternatives to formal bankruptcy where agreements or arrangements can be made with the creditors.<sup>22</sup> Note in Australia the term 'bankruptcy' is only used for personal insolvency.

Personal and corporate insolvency proceedings will be separately discussed in the following paragraphs by considering corporate liquidation (hereafter 'liquidation') and voluntary administration (hereafter 'administration') and then considering personal bankruptcy. Receivership will not be discussed.<sup>23</sup>

Both corporate and personal insolvency can be involuntary or voluntary. A company can commence a winding-up and if it is discovered that it is insolvent then it will change the proceeding to an involuntary one. There is no separate insolvency proceeding specifically for financial institutions and insurance companies.

The main characteristic for liquidation is that it is restricted to winding-up. A liquidator is to take control of the assets, realise them and then attempt to pay the creditors. At the end of the process the company must be deregistered. An administration has a number of characteristics and among them is the fact that they are not commenced in a court, there is a moratorium from creditors, and the rescue package if implemented can involve directors continuing on in their management role.

There is no maximum time prescribed for any liquidation and in voluntary administration the time frames for the first stage, that of enquiry and meetings, is dictated by the

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<sup>17</sup> Corporations Act 2001 (Cth) ss. 411–415.

<sup>18</sup> Corporations Act 2001 (Cth) ss. 435A–451D.

<sup>19</sup> Bankruptcy Act 1966 (Cth) s. 134(1)(a),(b).

<sup>20</sup> Corporations Act 2001 (Cth) Pt 5.3A.

<sup>21</sup> Corporations Act 2001 (Cth) Pt 5.2.

<sup>22</sup> Bankruptcy Act 1966 (Cth) Parts IX and X known as debt agreements and personal insolvency agreements respectively. It is not intended to refer to these in detail.

<sup>23</sup> Receivership can be initiated by the secured creditor or by the court. It generally 'opens' based on contract law and property law and the Corporations Act 2001 (Cth) dedicates only a small amount of provisions to this form of external administration. See further C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) ch. 7.

requirement to hold the second meeting of creditors (see below, section 1.15.2). There is no time period dictated for the completion of a deed of company arrangement and the time frame could be outlined in the instrument.

In personal insolvency one of the most significant characteristics is that the debtor will become a bankrupt for three years and then discharged. It is meant to be a 'fresh start' for the debtor's financial life. There are two paths that lead to bankruptcy, the voluntary one taken by the debtor, which is straightforward, and the involuntary one taken by creditors of the personal debtor, which is more complex. The sole ground for making a person bankrupt is that they have committed an act of bankruptcy.

The definition of 'insolvency' has been the source of debate over the years.<sup>24</sup> Both personal and corporate insolvency use a statutory definition that indicates the cash flow test is used. The statute covering corporate insolvency law, the Corporations Act 2001 (Cth), gives a definition of 'solvent' in s. 95A(1) as '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'. The following subsection, s. 95A(2), reads 'a person who is not solvent is insolvent'. The statute covering personal insolvency, the Bankruptcy Act 1966 (Cth) gives a definition of solvent in s. 5(2) as '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'. And s. 5(3) provides that 'a person who is not solvent is insolvent'. As we can see both pieces of legislation adopt an identical definition.<sup>25</sup> There have been calls for the doublet 'due and payable' to be pruned to just state 'payable' to create a clearer test.<sup>26</sup> Most judges in assessing insolvency apply the cash flow test and then move to the balance sheet test where appropriate, essentially providing that the two tests when used together give the best assessment of a person's solvency. There are no prescribed provisions to cater for insolvency proceedings that have large numbers of creditors or to deal with corporate debtors who have minimal or substantial assets.<sup>27</sup>

## 1.4 Special proceedings for particular types of debtors

### 1.4.1 Public entities

Under Australian law there are no dedicated provisions to deal with the insolvency of public entities. There is no history of a state, territory or municipality becoming insolvent.

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<sup>24</sup> See for example, J. Duns, "'Insolvency': Problems of Concept, Definition and Proof" (2000) 28 *Australian Business Law Review* 22; A. Marshall, "Is 'due and payable' a magic phrase?" (2007) 15 *Insolvency Law Journal* 115; A. R. Keay, "The insolvency factor in the avoidance of antecedent transactions in corporate liquidations" (1995) 21 *Monash University Law Review* 305; D. Morrison, "When is a company insolvent?" (2002) 10 *Insolvency Law Journal* 4.

<sup>25</sup> In critiquing the section Justice Palmer in *Southern Cross Interiors Pty Ltd (in liq) v Deputy Commissioner of Taxation* (2001) 53 NSWLR 213, 220 suggested the drafter of the section indulged in 'a surfeit of pleonasm' by using 'due and payable', 'as and when' and 'and only if' when each seem to contain unnecessary words.

<sup>26</sup> A. Marshall, "Is 'due and payable' a magic phrase?" (2007) 15 *Insolvency Law Journal* 115.

<sup>27</sup> In personal bankruptcy in the informal categories notably Pt IX Bankruptcy Act 1966 (Cth) there is a debt agreement procedure that has thresholds involving assets. In corporate insolvency the voluntary administration procedure suffered from criticism when a number of large enterprises used the procedures and the short time frames provided to hold creditors' meetings revealed how difficult compliance was. See for example *Rehabilitating Large and Complex Enterprises in Financial Difficulties* a Discussion Paper by Corporations and Market Advisory Committee (CAMAC) <<http://www.camac.gov.au/camac/camac.nsf/byHeadline/PDFDiscussion+Papers>> (accessed 16 August 2011).

#### *1.4.2 Credit institutions and insurance companies*

There are no special proceedings for insolvency or reorganisation outlined in Australia for banks, credit institutions or insurance companies. It is very rare for banks to consider insolvency given that Australia has significant regulatory control of banking business.<sup>28</sup>

There is nothing in principle prohibiting a bank, credit institution or insurance company or their creditors from using the Corporations Act 2001 (Cth) to liquidate, reorganise or appoint a receiver over them.<sup>29</sup>

#### *1.4.3 Other regulated businesses*

Generally there are no special insolvency proceedings with regard to regulated businesses such as farming and public utilities. The Bankruptcy Act 1966 (Cth) does have limited provisions in Part XIA with regard to stays that may apply to farmers who have been receiving debt assistance. It is possible in Australia to incorporate a company under a specialist statute dealing with indigenous businesses. The Act, the Corporations (Aboriginal and Torres Strait Islander) Act 2006, provides in Chapter 11 for a special administrator to be appointed.<sup>30</sup> It also provides for parts of the Corporations Act 2001 (Cth) that deal with insolvency to apply.<sup>31</sup> The special administrator will not outrank a liquidator but will have priority over a voluntary administrator or receiver.<sup>32</sup>

#### *1.4.4 Individuals/consumers*

The Bankruptcy Act 1966 (Cth) applies to all natural persons regardless of whether they are in business or not.<sup>33</sup> Under the Act there are no specific provisions dedicated to business debtors. The Act does allow for joint debtors to become bankrupt and ss. 56A–56G provide for a debtor's petition to be presented by all or a majority of the partners in a partnership and then outlines aspects of how such an estate will be conducted.

### **C. The conditions for the commencement of insolvency proceedings**

#### **1.5 Commencement requirements**

The Australian courts at both the state and federal level that hear insolvency matters enjoy a high level of independence and impartiality. As part of the inherited English common law system the judges are appointed, usually from the bar, by the executive arm of government. The removal of judges is rare and would take place with the involvement of the Governor (Governor General in the case of federal courts) and Parliament. The Australian legal system is based upon a fundamental belief in the rule of law, justice and the independence of the judiciary. The system uses an adversarial approach and each party has a right

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<sup>28</sup> For example, the federal government maintains a level of control through legislation such as the Reserve Bank Act 1959 (Cth), Banking Act 1959 (Cth) Financial Services Reform Act 2001 (Cth).

<sup>29</sup> The failure of one large insurance company HIH led the federal government to hold a Royal Commission, which was conducted by Justice Neville Owen. See <<http://www.hihroyalcom.gov.au>> (accessed 7 December 2010).

<sup>30</sup> Corporations (Aboriginal and Torres Strait Islander) Act 2006 Pt 11.2.

<sup>31</sup> Corporations (Aboriginal and Torres Strait Islander) Act 2006 s. 499.10.

<sup>32</sup> Corporations (Aboriginal and Torres Strait Islander) Act 2006 s. 496.10.

<sup>33</sup> Note the Bankruptcy Act 1966 (Cth) s. 7(1) states that the Act applies to 'debtors being persons who are not Australian citizens and persons who have privilege of Parliament' and s. 7(1A) states that this Act 'applies to debtors whether or not they have attained the age of 18 years'.

to representation. The court system is public and rarely will there be an instance of an in camera hearing.

For a company to be wound up compulsorily the court will require that the company is either insolvent or satisfies other grounds such as that the company has by special resolution resolved to wind up or that the affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to, or unfairly discriminating against a member.<sup>34</sup> In the insolvency situation the company, a creditor, a contributory, a director, a liquidator or the government regulator (ASIC) can apply to the court for an order that the company be wound up.<sup>35</sup> To assist with this application the court must presume that the company is insolvent if the company failed to comply with a statutory demand on some other grounds such as where a receiver is appointed or where a judgment execution process has failed to be wholly or partly satisfied.<sup>36</sup> A statutory demand can be issued for \$A2,000, an amount known as the statutory minimum. A non-petition clause will generally be enforceable subject to general contractual principles and legislation such as the Competition and Consumer Act 2010 (Cth), Australia's anti-trust legislation.

The most typical applications for winding-up orders are made by creditors on the ground that the company is unable to pay its debts.<sup>37</sup> Proving that the company is unable to pay its debts and therefore establishing the company's insolvency is done through the statutory demand procedure. Essentially, where the amount of the creditor's debt is at least the statutory minimum (\$A2,000) then he or she may serve on the company a statutory demand requiring payment of the debt within 21 days after the demand is served on the company.<sup>38</sup>

The statutory demand must be in writing in the prescribed form (Form 509H) and must be signed by or on behalf of the creditor and it must specify the debt and its amount.<sup>39</sup> The statutory demand must require the company to pay the amount of the debt, or to secure or compound for that amount to the creditor's reasonable satisfaction.<sup>40</sup>

Notwithstanding the apparent simplicity of the statutory demand procedure, in practice it is often fraught with pitfalls because of the technical nature of the procedure.<sup>41</sup>

Section 459H of the Corporations Act 2001 (Cth) provides solutions for the genuine dispute that the debtor company has with the statutory demand. Where there is a genuine dispute between a company and a creditor about the existence or the amount of a debt to which the statutory demand relates, then the court can determine the substantiated amount of the debt.

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<sup>34</sup> Corporations Act 2001 (Cth) s. 461.

<sup>35</sup> Corporations Act 2001 (Cth) s. 459P.

<sup>36</sup> Corporations Act 2001 (Cth) s. 459C.

<sup>37</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 278.

<sup>38</sup> Corporations Act 2001 (Cth) s. 459E.

<sup>39</sup> Corporations Act 2001 (Cth) s. 459E.

<sup>40</sup> Corporations Act 2001 (Cth) s. 459E(2)(a),(c).

<sup>41</sup> A. R. Keay, 'Finding a way through the maze that is the law of statutory demands (1998) 16 *Companies and Securities Law Journal* 122; M Stoney, 'Applications to set aside statutory demands – Has Division 3 of Part 5.4 achieved its stated objectives' (2000) 8 *Insolvency Law Journal* 96; K. Gorman, 'Sidestepping the statutory demand: Is solvency a solution?' (2002) 10 *Insolvency Law Journal* 239.

Section 459G of the Corporations Act 2001 (Cth) allows a company to apply, within 21 days after a statutory demand is served, for an order setting aside the demand. The time frame is critical as the application may only be filed and served within the 21 days allowed.

The statutory demand procedure may not be used as a debt-collecting tool despite how effective or costly it is.<sup>42</sup> Where ordinary proceedings are available for establishing the creditor's debt such as seeking judgment for the debt then the court will not permit the creditor to employ the statutory demand procedure.

For a company to commence to be wound up voluntarily there is no restriction.<sup>43</sup> However, if the directors cannot issue a declaration of solvency to the liquidator then the winding-up will change to a 'creditors' voluntary winding-up' and then the creditors will be much more involved.<sup>44</sup>

For a company to enter a voluntary administration there are few requirements and importantly there is no requirement to approach the court. There are three ways of opening an administration, firstly the directors can resolve at directors meeting to appoint an administrator, secondly if the company is already in liquidation then the liquidator can appoint an administrator, and finally a chargeholder that holds a charge over all or substantially all of the assets of the company can appoint an administrator.<sup>45</sup> By far the most popular way of opening an administration is the directors' resolution and this is due in part to the link to a defence to an action against the directors for insolvent trading if they take such action.<sup>46</sup> The liquidator would only open such proceedings if he or she had detected that there was a real possibility for reorganisation and that they should not continue to wind up the company. A chargeholder is most unlikely to open such proceedings as the legislation already provides for them to appoint a receiver to undertake a receivership to realise their charged assets.

Unlike in some countries there is no requirement for a company entering into voluntary administration to have the shareholders give their approval or attend general meetings. If the company enters a deed of company arrangement this deed binds the shareholders despite them not voting.<sup>47</sup> Members cannot transfer their shares whilst the administrator is in place unless the administrator or a court approves the transfer.<sup>48</sup>

Employee representatives are not required to approve the entering into voluntary administration. Later if a deed is proposed employee priorities are protected and a meeting of eligible employee creditors may be needed prior to the creditors meeting.<sup>49</sup>

An individual can open their own bankruptcy proceedings by filing a debtor's petition.<sup>50</sup> Once the petition and statement of affairs are presented and formally accepted by the Official Receiver endorsing it, the debtor automatically becomes bankrupt.<sup>51</sup> The statement of affairs requires the debtor to provide detailed information of assets, liabilities, income and

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<sup>42</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 282.

<sup>43</sup> Corporations Act 2001 (Cth) s. 494.

<sup>44</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 275

<sup>45</sup> Corporations Act 2001 (Cth) ss. 436A–436C.

<sup>46</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 236.

<sup>47</sup> Corporations Act 2001 (Cth) s. 444G.

<sup>48</sup> Corporations Act 2001 (Cth) s. 437E.

<sup>49</sup> Corporations Act 2001 (Cth) s. 444DA.

<sup>50</sup> Bankruptcy Act 1966 (Cth) s. 55.

<sup>51</sup> Bankruptcy Act 1966 (Cth) s. 55(4A).

personal details. As a preliminary to becoming bankrupt a debtor can file a declaration of intention to present a debtor's petition. The Official Receiver must accept a declaration if the debtor is entitled to present one and it is on the approved form. The Official Receiver will endorse it, sign the declaration and give a copy to the debtor.<sup>52</sup> In an attempt to have the bankrupt informed about the major step he or she is about to take in petitioning for their bankruptcy, they are given 'prescribed information'.<sup>53</sup> This information gives details about the alternatives to bankruptcy, the consequences of becoming bankrupt and sources of financial advice. If the debtor's petition is in order then the Official Receiver will accept and endorse it and the debtor is deemed to have become bankrupt at the beginning of that day.<sup>54</sup>

A creditor can open proceedings forcing an individual to be declared bankrupt so long as the debt (or debts) total \$A5,000.<sup>55</sup> In 2009 there was an attempt to change this amount to \$A10,000 and in 2010 it was amended but only to \$A5,000 from the previous amount of \$2,000. If there are two or more creditors, they can only present a petition if the debtor owes them all a total of at least \$5,000. The amount is arbitrarily arrived at but its purpose is to stop bankruptcy proceedings being used to enforce trivial debts.

A creditor begins bankruptcy proceedings when they file a petition asking the court to make a sequestration order in respect of the estate of a debtor. If the court makes such an order, the debtor thereupon becomes bankrupt. A creditor, or several creditors acting jointly, can present a petition if the debtor is not a corporation, partnership or association registered under a Commonwealth, state or territory law, or the Crown. The petitioning creditor needs to show that the debtor has committed an 'act of bankruptcy' (as described by s. 40 of the Bankruptcy Act 1966 (Cth)) within the six months before the presentation of the petition. The court will make a sequestration order if the debt is liquidated and payable either immediately or at a certain future time.<sup>56</sup> Secured creditors, defined in the Bankruptcy Act 1966 (Cth) s. 5(1) as a creditor 'holding a mortgage, charge or lien' over the debtor's property, can participate in creditors' petitions. Under s. 44(2) of the Bankruptcy Act 1966 (Cth) a secured creditor can petition, just like an unsecured creditor, if they state their willingness to surrender their security to the trustee for the benefit of the unsecured creditors. However, the secured creditor, who is unwilling to surrender a security, can only petition on the basis of the amount that would be still owed if the security was realised.

In bankruptcy law a creditor can make application to the Official Receiver and then obtain from the Official Receiver a bankruptcy notice requiring the debtor to pay the amount specified in the notice.<sup>57</sup> The creditor will have already obtained a final judgment or final order and the notice needs to be completed using the prescribed form.<sup>58</sup> The notice requires the debtor to pay or secure or compound payment and states what are the consequences of non-compliance and this usually means that failure to comply with a bankruptcy notice is an act of bankruptcy on which the creditor may found a creditor's petition.<sup>59</sup> Whilst there are other

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<sup>52</sup> Bankruptcy Act 1966 (Cth) s. 54C(a).

<sup>53</sup> Bankruptcy Regulations 1966 (Cth) reg. 4.11.

<sup>54</sup> Bankruptcy Act 1966 (Cth) s. 57A.

<sup>55</sup> Bankruptcy Act 1966 (Cth) s. 44.

<sup>56</sup> Bankruptcy Act 1966 (Cth) s. 44(1).

<sup>57</sup> Bankruptcy Act 1966 (Cth) s. 41.

<sup>58</sup> Bankruptcy Act 1966 (Cth) Form 1.

<sup>59</sup> Bankruptcy Act 1966 (Cth) s. 40(1)(g).

‘acts of bankruptcy’ it is suggested that over 95 per cent of creditors’ petitions are based on failing to comply with a bankruptcy notice.<sup>60</sup>

The courts have consistently stressed that, in view of the serious consequences facing a debtor served with a bankruptcy notice, creditors must comply strictly with these requirements:

- the applicant is a ‘creditor’ who has a ‘final judgment or order’ against the debtor;
- this judgment or order is one ‘the execution of which has not been stayed’;
- the judgment or order is for at least \$5,000.<sup>61</sup>

This is intended to reflect the serious consequences that follow a failure to comply with a bankruptcy notice.

A ‘final’ judgment or order is usually contrasted with an ‘interlocutory’ order, the latter being one on which execution could not issue. However the distinction is not always clearly drawn and has given rise to a considerable body of case law. The courts have insisted that a bankruptcy notice comply rigorously with the requirements of the Act. This has been justified on the traditional ground that failure to comply with a bankruptcy notice has severe consequences for a debtor.<sup>62</sup> Proceedings by debtors to have a bankruptcy notice set aside are common. The number and range of decisions dealing with defective or irregular bankruptcy notices suggest few limits on the kinds of defects that can arise. Section 306 of the Bankruptcy Act 1966 (Cth) provides that proceedings under the Act are not invalidated by a formal defect or an irregularity unless the court is of the opinion that substantial injustice is created by the defect or irregularity which cannot be remedied by an order of that court. A debtor served with a bankruptcy notice commits an act of bankruptcy unless he or she complies with a bankruptcy notice within the prescribed time limits or satisfies the court that he or she has a counterclaim, set-off or cross-demand of at least the amount owing and that such a claim could not have been set up in the proceeding in which the judgment or order was obtained.<sup>63</sup>

Compliance with a bankruptcy notice requires that the debtor either make or tender payment of the debt owed<sup>64</sup> or make an arrangement to the creditor’s satisfaction for settlement of the debt.<sup>65</sup> The time limit for compliance with a notice by a debtor is 21 days for notices served within Australia. If the notice is to be served outside Australia, the time for compliance is fixed by the court.<sup>66</sup>

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<sup>60</sup> M. Murray and J. Harris, *Keays’ Insolvency: Personal and Corporate Law and Practice* (2011) para. 3.175.

<sup>61</sup> On the issuing of bankruptcy notices, see generally *Re Sing* [1999] FCA 1055.

<sup>62</sup> See, for example, *Re Wimborne; Ex parte the Debtor* (1979) 24 ALR 494 at 499; *Re Williams; Ex parte Alberton Electrical Service Pty Ltd* (1982) 43 ALR 552 at 558; *Re O’Sullivan; Ex parte Bank of New Zealand* (1991) 30 FCR 112 at 114–15.

<sup>63</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 59.

<sup>64</sup> On tender, see *Ex parte Danks; Re Farley* (1852) 2 De GM & G 936; 22 LJ Bcy 73; 42 ER 1138. The tender must be unconditional tender: *Alcatel Australia Ltd v PRB Holdings Pty Ltd* (1998) 27 ACSR 708. The debtor may also make payment into court: *Re Smyth; Ex parte North (No 2)* (1892) 3 BC (NSW) 45. On payment by a bill of exchange, see *Ex parte Matthew; Re Matthew* (1884) 12 QBD 506; 51 LT 179; *Re Feast; Ex parte Feast* (1887) 4 Morr 37; 31 Sol Jo 286; *Re Lomax; Ex parte City Bank* (1892) 3 BC (NSW) 66.

<sup>65</sup> *Re Reicher; Ex parte Cm of Taxation* (1990) 34 FCR 206.

<sup>66</sup> Bankruptcy Act 1966 (Cth) s. 40(1)(g)(ii).

At the hearing, the petitioning creditor is required to satisfy the court<sup>67</sup> that the matters stated in the petition have been verified, that the petition was properly served and that the petitioning creditor's debt is still owing at the time of the hearing and is at least \$5,000.<sup>68</sup> On proof of these matters, the court will generally make the order.<sup>69</sup>

## 1.6 Liability for not filing in good time or filing too early

### 1.6.1 Liability for not filing in good time

There is no legal obligation for a debtor, either personal or corporate, to file to commence a bankruptcy or liquidation or administration.

In corporate insolvency there is incentive for filing in good time. Directors are encouraged to choose voluntary administration as a means of rehabilitation in a variety of ways. Firstly, s. 588G of the Corporations Act 2001 (Cth) provides for director's liability to pay compensation if the company trades whilst insolvent and to avoid such liability a defence is given (in s. 588H of the Corporations Act 2001 (Cth)) if the directors take steps such as commencing a Part 5.3A administration. Secondly, the appointment of an administrator will prevent creditors enforcing guarantees of company debts provided by a director's spouse or other relative. Thirdly, the treatment of debts arising under Income Tax Assessment Act 1936 (Cth) sees directors liable to indemnify the Commissioner of Tax if the company's payment of tax debt is taken to be a voidable transaction resulting in the Tax Office having to return it to the company's liquidator. There has been criticism in Australia that administration is entered into too early as directors fear the consequences of insolvent trading, that is that the law makes the directors unduly risk averse.<sup>70</sup> It has been said that Australia's insolvent trading laws are the harshest in the western world as it compels directors to place the company into administration where they cannot form the requisite view as to an expectation of solvency, even in circumstances where the interests of creditors might be better served by an informal work out.<sup>71</sup> There is no flexibility at all in the law as it presently exists but recently the government has sought comment<sup>72</sup> on whether there should be a business judgment safe harbour defence introduced for directors.<sup>73</sup>

If directors and members choose to liquidate their company this is commenced as a members voluntary winding-up using the general meeting to appoint liquidators.<sup>74</sup> Where the directors cannot produce a declaration of solvency and the liquidator is of the opinion that the company will not be able to pay its debts in full then the liquidator must apply for the company or be wound up in insolvency or enter an administration or convene a meeting of the

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<sup>67</sup> Bankruptcy Act 1966 (Cth) s. 52(1). See *Re Snowden; Ex parte Deputy Cmr of Taxation (Vic)* [1970] ALR 229; *Re Mackie; Ex parte Goldsbrough Mort and Co Ltd* [1958] QWN 31; (1958) 19 ABC 256.

<sup>68</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 63.

<sup>69</sup> The burden of proof is on the petitioner: see *Guss v Johnstone* (2000) 171 ALR 598; *Glew v Harrowell* (2003) 198 ALR 331.

<sup>70</sup> P. James, I. Ramsay and P. Siva, 'Research Report Insolvent Trading—An Empirical Study', <<http://www.claytonutz.com/downloads/InsolventTradingReport.pdf>>, p. 17 (accessed 8 December 2010).

<sup>71</sup> See for example J. Harris, 'Lessons from abroad: Its time to reform insolvent trading laws' (2009) 10(1) *Insolvency Law Bulletin* 2; H. Anderson, 'Directors' personal liability to creditors: theory versus tradition' (2003) *Deakin Law Review* 12

<sup>72</sup> <<http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1713>> (accessed 20 May 2011).

<sup>73</sup> L. Whitechurch, 'Should the law on insolvent trading be reformed by introducing a duty akin to the business judgment rule?' (2009) 17 *Insolvency Law Journal* 25

<sup>74</sup> Corporations Act 2001 (Cth) s. 495.

company's creditors.<sup>75</sup> The consequence, therefore, is not some criminal offence for not commencing the liquidation in good time merely that the voluntary nature moves to a process that gives creditors more involvement and decision-making power.

In bankruptcy the time period over which an individual will be bankrupted, that is usually three years, only commences from the time that they file their 'statement of affairs'.<sup>76</sup> It is therefore in the bankrupt's best interest to attend to this form within the 14 days prescribed by the Bankruptcy Act 1966 (Cth). The statement is crucial for the administration of the estate as it provides details of the bankrupt's assets and liabilities. The incentive to filing is that the sooner it happens the sooner the three-year period will be over and the bankrupt can become discharged.

### *1.6.2 Liability for filing too early*

There are no special provisions concerning premature filings. It has not been an identifiable problem in Australia that debtors would use the insolvency proceedings for advancing any particular ulterior or undue motives. There has been some commentary on 'strategic' bankruptcy in the sense that a company within a corporate group will be put into an insolvency proceeding after significant assets have been transferred to other companies within the group.<sup>77</sup> This has been the subject of two different responses. Firstly, the company directors may be engaging in what are known as 'phoenix companies' where for instance a company ceases trading and then a very similar company commences trading shortly after with a similar name, same (or most similar) directors and often from the same location. Due to the concepts of separate legal entity and limited liability the remaining debts, often to the taxation departments and government authorities and employees, are not obliged to be met by the new company.<sup>78</sup> There has been a limited legislative response to this behaviour providing for a deposit to be paid by the new company for future tax liabilities and director penalties.<sup>79</sup> Secondly, there was behaviour identified in the late 1990s that saw a company leaving its unionised workforce in an existing company with an administrator appointed while the assets and contracts were transferred to other companies in the group.<sup>80</sup> Again there has been a legislative response to this behaviour that now prohibits transfer of assets with the intention of denying employee entitlements.<sup>81</sup>

## **1.7 Procedural and jurisdictional issues**

### *1.7.1 Domestic insolvency proceedings*

When a company is registered the corporate regulator, ASIC, must specify the state or territory in which the company is taken to be registered despite the fact that the company's legal powers and capacity are not in any way dependent on states or territories. A company once registered can then be placed in liquidation or administration under the Corporations Act

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<sup>75</sup> Corporations Act 2001 (Cth) s. 496.

<sup>76</sup> Bankruptcy Act 1966 (Cth) ss. 54(1)(a), 56A(2).

<sup>77</sup> D. Noakes, 'Measuring the impact of strategic insolvency on employees' (2003) 11 *Insolvency Law Journal* 91.

<sup>78</sup> H. Anderson, 'Creditors rights of recovery: economic theory, corporate jurisprudence and the role of fairness' (2006) 30 *Melbourne University Law Review* 1.

<sup>79</sup> Tax Law Amendment (Transfer of Provisions) Act 2010 s. 255–100.

<sup>80</sup> This was known as 'the Patrick Tactic' and commented upon in D. Noakes, 'Dogs on the wharves: corporate groups and the waterfront dispute' (1999) 11 *Australian Journal of Corporate Law* 27.

<sup>81</sup> C. F. Symes, 'A new statutory directors' duty for Australia – a "duty" to be concerned about employee entitlements in the insolvent corporation' (2003) 12 *International Insolvency Review* 133.

2001 (Cth). Under Part 5.4 of this Act a company can be wound up in insolvency by order of 'the Court'.<sup>82</sup> The term 'Court' is defined to include the Federal Court, the Supreme Court of a state or territory and the Family Court of Australia.<sup>83</sup>

As noted the administration does not 'open' with court involvement. The administration begins when an administrator is appointed either by resolution of the board,<sup>84</sup> a liquidator<sup>85</sup> or by a person entitled to enforce a charge on the whole or substantially the whole of the company's property.<sup>86</sup> As soon as practicable after being appointed the administrator must make a declaration of relevant relationships and a declaration of indemnities.<sup>87</sup> These declarations are then sent to as many creditors as reasonably practicable.<sup>88</sup> A creditors meeting follows shortly afterward at which the declaration is tabled.<sup>89</sup>

An individual as a debtor can be affected by the Bankruptcy Act 1966 (Cth) regardless of whether they are a citizen or not.<sup>90</sup> Debtors petitioning for their own bankruptcy must at the time of presentation be personally present or ordinarily resident in Australia or have a dwelling house or place of business in Australia or be carrying on a business in Australia, either personally or by means of a manager or agent.<sup>91</sup>

For a creditors petition the debtor is required to have a connection with Australia and this is satisfied if at the time of the act of bankruptcy the debtor is personally present in Australia, is ordinarily resident in Australia or has a dwelling house in Australia or the debtor has a place of business in Australia or is carrying on business in Australia or is a member of a partnership that is carrying on business in Australia.<sup>92</sup> Some acts of bankruptcy (an act of bankruptcy is required in all bankruptcies) specify that the act can be committed 'in Australia or elsewhere'.<sup>93</sup>

The Bankruptcy Act applies to debtors whether or not they have attained the age of 18 years.<sup>94</sup> Rarely there will be a person of unsound mind who wishes to present a debtor's petition and state legislation commonly authorises agents to represent incapacitated persons.

For bankruptcy matters the Federal Court has both original and appellate jurisdiction.<sup>95</sup> The Family Court also has jurisdiction. State and territory courts have a limited role if they are cross-vested or they are hearing debt-related litigation. For corporate and personal insolvency matters the Federal Court has a substantial and diverse appellate jurisdiction and can hear appeals from final judgments in insolvency decisions *inter alia* made by single judges of the court to the full court and decisions of the Federal Magistrates Court to either the full

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<sup>82</sup> Corporations Act 2001 (Cth) s. 459A.

<sup>83</sup> Corporations Act 2001 (Cth) s. 58AA.

<sup>84</sup> Corporations Act 2001 (Cth) s. 436A.

<sup>85</sup> Corporations Act 2001 (Cth) s. 436B.

<sup>86</sup> Corporations Act 2001 (Cth) s. 436C.

<sup>87</sup> Corporations Act 2001 (Cth) s. 436DA(2).

<sup>88</sup> Corporations Act 2001 (Cth) s. 436DA(3).

<sup>89</sup> Corporations Act 2001 (Cth) s. 436E.

<sup>90</sup> Bankruptcy Act 1966 (Cth) s. 7.

<sup>91</sup> Bankruptcy Act 1966 (Cth) s. 57(2A).

<sup>92</sup> Bankruptcy Act 1966 (Cth) s. 43(1)(b).

<sup>93</sup> Bankruptcy Act 1966 (Cth) s. 40(1)(a), (b).

<sup>94</sup> Bankruptcy Act s. 7.

<sup>95</sup> Bankruptcy Act s. 27.

court or a single judge. The complex rules appropriate to appeals are detailed in the Federal Court Rules 2011.<sup>96</sup>

### *1.7.2 Cross-border insolvency proceedings*

In 2008 the Cross-Border (Insolvency Act), which incorporates the UNCITRAL Model Law on Cross-Border Insolvency, was introduced and this imposes a mandatory obligation on the Australian courts to cooperate with courts or representatives of foreign jurisdictions.<sup>97</sup> For bankruptcy this enhances the existing provision which required Australian courts to assist the bankruptcy courts of some 'prescribed' countries<sup>98</sup> and could choose to assist the rest of the countries.<sup>99</sup> For corporate insolvency, s. 581 of the Corporations Act 2001 (Cth) applied the same mutual assistance provision as bankruptcy to any external administration matter. Now the Cross-Border (Insolvency) Act enhances this situation as well so that it becomes mandatory for Australian courts to cooperate with all jurisdictions.

Australia has chosen to adopt the Model Law for both bankruptcy and liquidation on the grounds of insolvency and voluntary administration.<sup>100</sup> The adoption is with little amendment from the Model Law Articles. There are a few exclusions of entities such as insurance companies, life insurance companies and deposit-taking institutions (banks) that have been placed outside the scope of the Model Law for policy reasons.<sup>101</sup> Importantly, there is no definition attached to COMI because it was considered that there was a considerable body of common law in existence in other jurisdictions and that the Australian courts would be guided by that body of law.<sup>102</sup>

## **1.8 Costs and funding of the proceedings**

### *1.8.1 Costs of the proceedings*

The commencement of an action to wind up a company by a creditor is paid for by the creditor and they receive a priority for these costs and expenses in the distribution.<sup>103</sup> A liquidation is funded from the remaining assets of the company. For compulsory liquidations it is common for the court to appoint a liquidator using the 'cab-rank' system of taking the next name on the court's list. This can result in some appointments where there are not sufficient assets to cover the costs and the liquidator must go without their full fees. This is sometimes used as an argument to justify the high fees charged by the insolvency profession.<sup>104</sup>

An administrator is funded from the company's assets. As the appointment does not involve the court there are no 'opening' court costs.

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<sup>96</sup> See <<http://www.comlaw.gov.au/Details/F2011L01551>>, ch. 4 'Appellate Jurisdiction' (accessed 8 December 2010).

<sup>97</sup> Cross Border (Insolvency) Act ss. 21, 22.

<sup>98</sup> Bankruptcy Act 1966 (Cth) s. 29(2).

<sup>99</sup> Bankruptcy Act 1966 (Cth) s. 29(3).

<sup>100</sup> Cross Border (Insolvency) Act 2008 (Cth) s. 8.

<sup>101</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 368.

<sup>102</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 371 quoting the Explanatory Memorandum of the Cross Border Insolvency Bill 2008 (Cth).

<sup>103</sup> Corporations Act 2001 (Cth) s. 556(1)(b).

<sup>104</sup> In 2010 a submission by the professional body for insolvency practitioners in Australia, the IPA, they stated 'Insolvency practitioners have a high instance of non-recoverable work compared to other professions. In a recent survey, 30% of IPA members reported that they expected not to be remunerated for 20–25% of the appointments they undertook in 2009.' <<http://http://www.ipaa.com.au/default.asp?menuid=175&artid=792>>, Chapter 5.1, p. 22.

In personal bankruptcy a large majority (84 per cent) of the administrations are performed by the Official Trustee in Bankruptcy, a federal government funded agency.<sup>105</sup> There is a nominal cost to the bankrupt. Approximately 16 per cent of personal bankruptcy administrations are performed by registered trustees who are accountants in private practice.<sup>106</sup> These practitioners charge fees usually on an hourly rate basis.

The government can give written directions that the cost of any proceedings or inquiries undertaken by trustees will be paid by them if the funds in the estate are insufficient to meet those costs.<sup>107</sup>

### 1.8.2 Funding of the proceedings

In liquidation the petitioning party such as a creditor is not required to meet any of the funding of the winding-up. If the company was to decide to wind up itself then the company assets would be used in the normal way to meet the administration expenses as a priority before distribution to the creditors. The liquidator has a specific power to obtain credit and can give the company's property as security and Australia has yet to legislate specifically on post-commencement financing priority.<sup>108</sup> There is no statutory expectation to seek the approval of the court or creditors. If a financier was sought by the liquidator and it was in the course of his or her administration then the financier's costs would become expenses that enjoy a priority if they were incurred in preserving, realising or getting in the company's property.

In administration as the commencement can arise from actions by the directors, liquidator or chargeholder it is the company who bears the cost of funding the proceedings. While the company is under administration the administrator may perform any function and exercise any power that the company or any of its officers could perform if it were not under administration.<sup>109</sup> Therefore, the administrator could seek financing and it would be the company who would fund this move. As the administrator is in place for such a short period this is unlikely. If a deed of company arrangement was in place it would be expected that new financing would have been contemplated and then feature as part of the deed's clauses. It would be up to the creditors voting for the deed to determine whether the company was to meet this expense or whether a third party was to contribute.

In bankruptcy, the Insolvency and Trustee Services Australia, who conduct most of the administrations, charge \$A3,200 plus 20 per cent of the money received and \$A50 per 15 minutes to manage the bankrupt's business. This money is taken from the bankrupt's estate and the petitioning creditor is not expected to contribute to the cost of the bankruptcy.

In recent years the government has provided for an Assetless Administration Fund which is designed to finance preliminary investigations and reports into the failure of companies with few or no assets because in such liquidations the liquidator may not have the funds to be able to carry out full investigations into the circumstances of the insolvency or prepare full reports for ASIC. By funding the liquidator the government hopes that possible offences or other misconduct by company officers may be brought to the attention of the corporate regulator,

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<sup>105</sup> Annual Report of the Inspector General in Bankruptcy 2009–2010, p. 9.

<sup>106</sup> *Ibid.*

<sup>107</sup> Bankruptcy Act s. 305.

<sup>108</sup> Corporations Act 2001 (Cth) s. 477(2)(g).

<sup>109</sup> Corporations Act 2001 (Cth) s. 437A(1)(d).

ASIC.<sup>110</sup> In bankruptcy a trustee could seek funding under s. 305 of the Bankruptcy Act 1966 (Cth) to further investigate an estate.

### **1.9 Publicity of filing and commencement of insolvency proceedings**

In a liquidation all company stationery must include the reference to 'in liquidation'. Creditors meetings will be advertised in national newspapers and creditors are invited to complete proofs of debt from advertisements in those newspapers.<sup>111</sup> Notice of appointment must be given to the corporate regulator, ASIC, within 14 days and the Commissioner of Taxation and to become registered as a representative of the company for the purposes of the goods and services tax within 21 days.<sup>112</sup>

During an administration the company must refer to it as being 'in administration', that is the first stage, or 'under a deed of company arrangement', that is the second stage, in all public documents. Notice of the appointment is published in a national newspaper or a daily newspaper in the state or territory in which the company has a registered office within three business days.<sup>113</sup> Again creditors meetings will be advertised in national or daily newspapers.

The administrator must attempt to contact all the company's creditors at least five business days before the first meeting (which must be held within eight business days of he or she being appointed).<sup>114</sup> In a major administration in 2001 involving one of the country's major airlines, the 16,000 employees were permitted by a court order to be advised of meetings through notices in the national newspapers and via a website.<sup>115</sup>

In personal bankruptcy in Australia there is a National Personal Insolvency Index (NPII) which is maintained by the Inspector General and it is an electronic index.<sup>116</sup> It records comprehensive details of bankruptcies, including the names and contact details of the bankruptcy trustees responsible for individual bankrupts. The NPII can be accessed by the public upon the payment of a fee. Bankruptcy appointments do not appear in the newspaper.

There is no separate notification of individual creditors except secured creditors<sup>117</sup> and no additional requirements for publicity in foreign countries.

### **1.10 Group/parallel proceedings**

#### *1.10.1 Joint administration*

Companies that belong to a corporate group and where all the companies are insolvent will often have the same liquidator or administrator unless of course he or she has a conflict of interest or is unable to complete a declaration of independence relevant relationships and

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<sup>110</sup> <[http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/RG109.pdf/\\$file/RG109.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/RG109.pdf/$file/RG109.pdf)> (accessed 20 May 2011).

<sup>111</sup> Corporations Regulations 2001 (Cth) reg. 5.6.14A.

<sup>112</sup> Corporations Act 2001 (Cth) s. 537, Taxation Administration Act 1953 (Cth) s. 260–45, A New Tax System (Goods and Services Tax) Act 1999 (Cth).

<sup>113</sup> Corporations Act 2001 (Cth) s. 450A(1).

<sup>114</sup> Corporations Act 2001 (Cth) s. 436E.

<sup>115</sup> *In the matter of Ansett Australia Limited and Mentha* [2002] FCA 2.

<sup>116</sup> Bankruptcy Act 1966 (Cth) Sch 8.

<sup>117</sup> For example on the appointment of an Administrator the chargee must be notified within one business day; Corporations Act 2001 (Cth) s. 450A(3).

indemnities (DIRRI).<sup>118</sup> There is no specific statutory provision in the Corporations Act that applies to the commencement or even the contributions of corporate group assets apart from Part 5.6 Div. 8 with regard to ‘pooling’<sup>119</sup> where each company in the group is being wound up and the liquidator may determine that the group is a ‘pooled group’ and it is just and equitable as between the various creditors of the companies in the group.<sup>120</sup> The consequences are that each company in the group becomes jointly and severally liable for each debt payable.<sup>121</sup> Creditors are still given power to approve or vary the pooling determination of the liquidator<sup>122</sup> and the court, too, has power to vary or terminate the pooling determination.<sup>123</sup> The court also has the power to determine a ‘pooled group’ will be used for the winding-up of a corporate group.<sup>124</sup>

In administrations there was a suggested legislative change in 2007 to allow for pooling in voluntary administrations, where an administrator could have prepared a pooling proposal in a DoCA with the unanimous consent of the creditors and court approval of the pooling proposal if that consent was not forthcoming. However it was not legislated for and so administrations do not have legislative direction on this point apart from a general provision, s. 447A of the Corporations Act 2001 (Cth) which gives the court power to make such orders as it thinks appropriate about the administration of any particular company. There is a jurisprudence of cases that discussed the appropriateness of permitting related companies in the corporate group proceeding through administration with pooled assets.<sup>125</sup>

In bankruptcy it is not uncommon to have spouses both bankrupt. Again it may be expeditious to have the one trustee administer both estates. The Bankruptcy Act 1966 (Cth) is silent on stipulating who is to administer although it does contemplate joint debtors who are not partners (in the business context).<sup>126</sup> The requirements mostly reflect those discussed here for a single natural person. Two principles guide trustees; firstly, where estates are inextricably blended and therefore near impossible for a trustee to keep them distinct for the purposes of joint and separate distributions, the court is likely to order that they be consolidated.<sup>127</sup> Consolidations may be appropriate and provide a more equitable return to all creditors even where joint bankrupts become bankrupt on different dates.<sup>128</sup> The other principle is that joint property must be applied to pay joint debts and separate property must be applied to pay separate debts.<sup>129</sup>

### 1.10.2 Substantive consolidation

There is no substantive consolidation other than the process mentioned immediately above.

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<sup>118</sup> Corporations Act 2001 (Cth) s. 506A

<sup>119</sup> Defined as ‘the practice of treating the affairs of a group of companies as if it were a single external administration’ by ASIC.

<sup>120</sup> Corporations Act 2001 (Cth) s. 571(1).

<sup>121</sup> Corporations Act 2001 (Cth) s. 571(2).

<sup>122</sup> Corporations Act 2001 (Cth) s. 574.

<sup>123</sup> Corporations Act 2001 (Cth) s. 579A.

<sup>124</sup> Corporations Act s. 579E.

<sup>125</sup> These are discussed in J. Harris, ‘Corporate group insolvencies: charting the past, present and future of pooling arrangements’ (2007) 15 *Insolvency Law Journal* 78; J. Harris, ‘The revised statutory pooling provisions’ (2007) 19(3) *Australian Insolvency Journal* 28.

<sup>126</sup> Bankruptcy Act 1966 (Cth) s. 57.

<sup>127</sup> Bankruptcy Act 1966 (Cth) s. 53.

<sup>128</sup> *Re Francis; Ex parte Official Trustee in Bankruptcy* (1988) 82 ALR 335.

<sup>129</sup> Bankruptcy Act 1966 (Cth) s. 110(1).

## **D. Institutions, participants and the conduct of/ control over the proceedings**

### **1.11 The debtor**

The Corporations Act 2001 (Cth) provides for the opening of liquidation and administration proceedings for body corporates such as companies incorporated under the legislation. This legislation governs public companies both listed on a stock exchange and those that are unlisted as well as all proprietary companies that are companies with fewer than 50 non-employee shareholders.<sup>130</sup>

The debtor company is not divested of property upon entering either liquidation or voluntary administration. The company as a separate legal entity continues and therefore the assets can continue to be held by the corporate body. The debtor company will retain capacity to perform legal acts and so the liquidator or administrator can act on behalf of the company as agent. Essentially it is management powers that move from the directors to the external administrator. The powers of directors are suspended.<sup>131</sup> Directors of the debtor company must attend when requested, tell the whereabouts of the books and give such information as reasonably required on the business, property, affairs and financial circumstances of the company.<sup>132</sup> These expectations are owed to the liquidator or administrator and failure to comply is a criminal offence, which will usually result in a monetary fine or in extreme cases a term of imprisonment. It is interesting to note that a debtor-in-possession concept is not a feature of Australian law although when a company enters a deed of company arrangement it is possible for the deed administrator to have lesser management duties and the directors return to some of their previous management roles.<sup>133</sup>

Under the Bankruptcy Act 1966 (Cth) individuals as debtors can commence bankruptcy proceedings or have such proceedings imposed upon them by the action of a creditor. Individuals who operate with others in partnership can also be subject to bankruptcy proceedings under this Act as partners.

### **1.12 The insolvency administrator**

For companies use is made of the one registration to assess who can carry out the variety of insolvency proceedings. The Corporations Act 2001 (Cth) gives power to the federal government's corporate regulator, ASIC, to grant registration to accountants who have satisfied that they have appropriate educational qualifications and experience and that they are fit and

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<sup>130</sup> Australia has five types of company: company limited by share, company limited by guarantee, unlimited company, no liability company and company limited by shares and guarantee. Proprietary limited companies can be either small or large depending on satisfying two of the three criteria; the consolidated gross operating revenue (<\$A25m for small), consolidated gross assets (<\$A12.5m for small) and 50 full-time equivalent employees.

<sup>131</sup> Corporations Act 2001 (Cth) s. 471A (liquidation) and s. 437C (administration).

<sup>132</sup> Corporations Act 2001 (Cth) s. 530A (liquidation) and s. 438B (administration).

<sup>133</sup> This is the effect of s. 444A and Sch. 8A which does not exclusively prescribe the terms of the deed. It is also the case that a deed is entered into and quickly terminated with a creditors trust established that sees the administrator move to being a trustee and the directors resuming control as the company is no longer under administration.

proper persons to be ‘registered liquidators’.<sup>134</sup> Once registered a ‘registered liquidator’ can accept appointments for most liquidations including creditors’ voluntary liquidations, members’ voluntary liquidations, receiverships and administrations at both the voluntary administration and deed of company arrangement stages. There is a separate requirement for companies that are placed into liquidation by the court. Here the court will appoint only ‘official liquidators’ and these are accountants who match the same requirements as registered liquidators but who are appointed from the court’s own list and they become officers of the court.<sup>135</sup> The number of insolvency practitioners (registered liquidators) in Australia is 664.<sup>136</sup> There are no more detailed statistics publicly available on caseloads and statistical information is relatively sparse with statistics generally confined to number of appointments per month and recorded for state in Australia.

There is one main professional body for insolvency practitioners known as the Insolvency Practitioners Association of Australia (IPA, previously IPAA). Membership is voluntary and over 80 per cent of insolvency practitioners are members. Additionally, many insolvency practitioners are members of the Institute of Chartered Accountants in Australia (ICA).

The remuneration of insolvency practitioners is a complex and keenly debated topic in Australia. For a compulsory liquidation s. 473(3) provides that:

A liquidator is entitled to receive such remuneration by way of percentage or otherwise as is determined; (a) if there is a committee of inspection – by agreement between the liquidator and the committee of inspection; or (b) if there is no committee of inspection or the liquidator and the committee of inspection fail to agree: (i) by resolution of the creditors; or (ii) if no such resolution is passed – by the Court.

The smoothest path is clearly the agreement between liquidator and committee of inspection and the other creditors can have this reviewed, using s. 473(5), provided the creditor or creditors who wish to complain hold at least 10 per cent of the total amount of proved debts.<sup>137</sup> Section 473(3)(b) provides options if there is no agreement by the committee of inspection and s. 473(4) requires all creditors to be sent a notice of meeting and a statement of all receipts and expenditure and the amount of remuneration sought. The creditors meeting can then approve the remuneration. Section 473(4A) covers the situation where the creditors meeting fails to achieve a quorum and it is then that the creditors are taken to have passed a resolution that the liquidator is entitled to \$5,000 or such greater amount as is prescribed or a lesser amount if the liquidator determines! Whether the remuneration is being approved by the committee of inspection or the creditors meeting the liquidator must always prepare a report setting out information that will enable the approving body to make an informed assessment as to whether the proposed remuneration is reasonable, a summary of the major tasks already performed and those likely to be performed and finally the costs associated with each major task.<sup>138</sup>

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<sup>134</sup> Corporations Act 2001 (Cth) s. 1282. See further, J. Fitzpatrick, V. Brand, and C. F. Symes, “Fit and proper”: the integrity requirement for liquidators’ (2010) 24 *Australian Journal of Corporate Law* 244

<sup>135</sup> Corporations Act 2001 (Cth) s. 1291.

<sup>136</sup> ASIC Annual Report 2009–2010 on p. 79 available at <[http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ASIC\\_AnnualReport-2009-10-Pt3.pdf](http://www.asic.gov.au/asic/pdf/lib.nsf/LookupByFileName/ASIC_AnnualReport-2009-10-Pt3.pdf)> (accessed on 17 August 2011).

<sup>137</sup> If sufficient support cannot be secured then s. 536 could be used for an inquiry into liquidator’s conduct by court or ASIC. See also *Australian Securities and Investments Commission v Edge* (2007) 211 FLR 137.

<sup>138</sup> Corporations Act 2001 (Cth) s. 473(11), (12).

The involvement of the court in the determining of remuneration is a last resort. The liquidator must seek the approval from the committee of inspection or creditors meeting before coming to the court.<sup>139</sup> In voluntary liquidations much the same regime applies to remuneration of liquidators. For creditors' voluntary liquidations s. 499(3) is drafted in similar terms to s. 473(3) and provides that 'the remuneration to be paid to a liquidator may be fixed (a) if there is a committee of inspection – by that committee; or (b) by resolution of the creditors'.

Administrations under Pt 5.3A with a view to executing a DoCA also have statutory attention given to remuneration. Section 449E(1) provides that:

[T]he administrator of a company under administration is entitled to receive such remuneration as is determined (a) by agreement between the administrator and the committee of creditors (if any); or (b) by resolution of the company's creditors; or (c) if there is no such agreement or resolution – by the Court.

Section 449(1A) grants the same treatment to administrators of companies under DoCAs. The resolution must not be bundled with any other resolution.<sup>140</sup> The court can determine remuneration if there has been no meeting of the committee of inspection (with DoCAs), the committee of creditors or creditors (with administrations).<sup>141</sup>

There is no statutory direction or formula to provide a basis for calculating remuneration. The statutory expectation is that it be 'reasonable'.<sup>142</sup> There is judicial expectation that it be 'reasonable'.<sup>143</sup> But there is no fixed scale of remuneration and no legislative direction on methods that could be permissible apart from s. 473(3) which goes the closest by stating 'remuneration by way of percentage or otherwise'. In Australia it is the time basis of assessment that is common and it is likely to stay that way.<sup>144</sup> The CPP provides four options that include both percentage and time basis.

The most discussed judicial comment in recent years is Finkelstein J.'s judgment in *Re Korda; Stockford Ltd* (2004) 140 FCR 424 where he suggests borrowing from the US the use of the 'lodestar' amount.<sup>145</sup> Such an amount is reached by the number of hours reasonably spent by the insolvency practitioner multiplied by a reasonable hourly rate.<sup>146</sup> This step requires consideration on whether the work performed was necessary to the administration, whether it was performed within a reasonable time and whether the rate is reasonable having regard to what the practitioner, and other practitioners, usually charge their clients.<sup>147</sup> The next step is to adjust upwards or downwards to reflect other factors including the quality of the work performed, the complexity of the administration, the novelty and difficulties that had to be confronted and the ultimate result.<sup>148</sup> The changes to the Corporations Act that

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<sup>139</sup> *Re Interchase Corp Ltd (in liq)* (1993) 44 FCR 501; *Walker & anor as liquidators of OneTel Ltd* (2005) 23 ACLC 1276.

<sup>140</sup> Corporations Act 2001 (Cth) s. 449E(1B).

<sup>141</sup> Corporations Act 2001 (Cth) s. 449E(1C), (1D).

<sup>142</sup> The court when exercising power to review must have regard to whether remuneration is reasonable, for example see Corporations Act 2001 (Cth) s. 473(10) for court appointed liquidators.

<sup>143</sup> See *Re Korda; Stockford Ltd* (2004) 52 ACSR 279.

<sup>144</sup> Gronow, *McPherson's Law of Company Liquidation* (2009) para. 8.2470.

<sup>145</sup> *Re Korda; Stockford Ltd* (2004) 140 FCR 424 at [47].

<sup>146</sup> *Ibid.*

<sup>147</sup> *Ibid.*

<sup>148</sup> *Ibid.*

were effective from 31 December 2007 incorporated some of these ideas, for instance aspects of 'complexity' and 'difficulties' such as when dealing with receivers or creditors' attributes when courts are reviewing reasonable remuneration.

There is no provision in the law for the liquidator or administrator to access public funds if there are insufficient funds to pay remuneration. The practitioner will bear the loss and would be expected to complete the task.

A liquidator is required to investigate the affairs of the company, the causes of the failure and the past conduct of its business because he or she has to prepare a report on the company under s. 476 of the Corporations Act 2001 (Cth). The investigation will assist to locate the assets of the company, compile the liabilities and to identify and prosecute any breaches of duty by delinquent officers of the company. Whilst the assets of the company do not automatically vest in the liquidator's name a liquidator is a fiduciary and as such is expected to take all reasonable steps to preserve the property of the company until he or she realises the stock-in-trade and other assets in the course of the winding-up. Often the assets of the company include a business that may be sold more profitably as a going concern and s.477(1)(a) of the Corporations Act 2001 (Cth) permits the liquidator to carry on the business pending its sale. Such an action will hopefully preserve the goodwill and make it a factor in the sale price. The liquidator's powers to carry on the business are limited to carrying it on with a view to its beneficial disposal or winding-up.<sup>149</sup> The liquidator has no power to conduct the business with the hope of rescuing the company although there is power to press for an administration (Part 5.3A using s. 436B of the Corporations Act 2001 (Cth)).

An administrator must give his or her consent in writing to being appointed.<sup>150</sup> The administrator must be seen to be independent and therefore cannot have a position such as an officer or auditor in the company or an officer of its mortgagee, or be a substantial creditor.<sup>151</sup> The appointment as an administrator cannot be revoked although the court may remove such an administrator and replace them. Section 437A of the Corporations Act 2001 (Cth) provides powers to the administrator and gives a good indication of the role of the administrator and the effects of the appointment. It reads:

**[Powers of administrator.]** While a company is under administration, the administrator: (a) has control of the company's business, property and affairs; and (b) may carry on that business and manage that property and those affairs; and (c) may terminate or dispose of all or part of that business, and may dispose of any part of that property; and (d) may perform any function, and exercise any power, that the company or any of its officers could perform or exercise if the company were not under administration.

Furthermore the administrator when performing a function or exercising a power as administrator is acting as agent for the company.<sup>152</sup>

The personal liability of an administrator or liquidator will arise where the practitioner acts *mala fide* in the form of fraud or negligence. The court and the corporate regulator can inquire into a liquidator's behaviour and if they find it is a case of misfeasance, neglect or

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<sup>149</sup> Corporations Act 2001 (Cth) s. 477(1)(a).

<sup>150</sup> Corporations Act 2001 (Cth) s. 448A.

<sup>151</sup> Corporations Act 2001 (Cth) s. 448C. See further C. Anderson, 'Miracle workers or ambulance chasers? The role of administrators in the Part 5.3A process.' (2004) 12 *Insolvency Law Journal* 238.

<sup>152</sup> Corporations Act 2001 (Cth) s. 437B

omission they can require the liquidator to make good any loss.<sup>153</sup> In administrations the court is satisfied that the administrator is managing or doing an act or making an omission that is prejudicial to the interests of some or all of the company's creditors or members then they may make what orders they think just which could include making good any loss.<sup>154</sup>

Once licensed, ASIC, the corporate regulator, monitors whether or not insolvency practitioners are adequately and properly performing their duties, and ITSA carries out inspections of practices of the trustees in bankruptcy. ASIC can bring complaints before the Companies Auditors and Liquidators Disciplinary Board (CALDB) under s. 1292 of the Corporations Act. Appeals from this board go to the Administrative Appeals Tribunal or on matters of law to the Federal Court. CALDB is an independent statutory body established under the ASIC Act 2001 (Cth). It has a public protective role by virtue of its jurisdiction to cancel or suspend the registration of a liquidator.<sup>155</sup> The Board is required by the Corporations Act to determine whether a registered liquidator has contravened provisions of the Act, has failed to carry out their duties and functions adequately and properly, is not a fit and proper person to remain registered, is subject to disqualification or is otherwise ineligible to remain registered. The CALDB when dealing with liquidators categorises matters into 'administrative' and 'conduct'. Each has different sanctions. The administrative category includes: failing to lodge a statement under s. 1288;<sup>156</sup> ceasing to be a resident in Australia;<sup>157</sup> failing to lodge a statement under s. 1288(5);<sup>158</sup> ceasing to be a resident in Australia (liquidator of specified body);<sup>159</sup> becoming disqualified from managing a corporation under Pt 2D.2;<sup>160</sup> becoming incapable because of mental infirmity of managing affairs.<sup>161</sup> Administrative breaches of s. 1292(7)(a) and (b) provide the CALDB with simple decision-making—they must cancel the registration, and for breaches of s. 1292(2) and (3) they may cancel or suspend registration.

The conduct category includes: failing to carry out the duties of a liquidator;<sup>162</sup> failing to carry out the duties or functions required by an Australian law to be carried out by a registered liquidator;<sup>163</sup> not being a fit and proper person to remain registered as a liquidator;<sup>164</sup> failing to carry out the duties of a liquidator of a body corporate or otherwise not being a fit and proper person to remain registered as a liquidator of that corporation (liquidator of specified body).<sup>165</sup> The conduct breaches of s. 1292(2)(d) and (3)(d) can render insolvency practitioners liable to cancellation of registration, suspension, admonishment, reprimand or can require undertakings. It is interesting to note that CALDB has no power to order recompense or mandatory remedial education.

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<sup>153</sup> Corporations Act 2001 (Cth) s. 536.

<sup>154</sup> Corporations Act 2001 (Cth) s. 447E.

<sup>155</sup> Magarey, 'Law Reform and the CALDB' (Jan–Mar 2007) *Australian Insolvency Journal* 10.

<sup>156</sup> Corporations Act 2001 (Cth) s. 1292(2)(a)(i).

<sup>157</sup> Corporations Act 2001 (Cth) s. 1292(2)(a)(ii).

<sup>158</sup> Corporations Act 2001 (Cth) s. 1292(3)(a)(i).

<sup>159</sup> Corporations Act 2001 (Cth) s. 1292(3)(a)(ii).

<sup>160</sup> Corporations Act 2001 (Cth) s. 1292(7)(a).

<sup>161</sup> Corporations Act 2001 (Cth) s. 1292(7)(b).

<sup>162</sup> Corporations Act 2001 (Cth) s. 1292(2)(d)(i).

<sup>163</sup> Corporations Act 2001 (Cth) s. 1292(2)(d)(ii).

<sup>164</sup> Corporations Act 2001 (Cth) s. 1292(2)(d).

<sup>165</sup> Corporations Act 2001 (Cth) s. 1292(3)(d).

Registered liquidators are required to maintain adequate and appropriate professional indemnity insurance and fidelity insurance.<sup>166</sup>

For bankruptcy it is possible to have the federal government's Official Trustee in Bankruptcy perform the role of trustee of the insolvent estate. Accountants can be registered under the Bankruptcy Act 1966 (Cth) to be 'registered trustees'. The requirement is that the applicant for registration has experience, knowledge and abilities as prescribed, two referees, and education that included three years of study in accountancy and two years study in commercial law. Trustees are highly regulated under the Bankruptcy Act 1966 (Cth) because of the power they hold and the tasks they are expected to undertake.<sup>167</sup> This regulation goes to independence and accountability<sup>168</sup> and to high standards in honesty, impartiality and probity particularly as a trustee is an officer of the court.<sup>169</sup>

### 1.13 Court supervision

Both the Federal Court of Australia and the six state supreme courts have jurisdiction for corporate law matters and therefore corporate insolvency. For liquidations any of these courts can be requested to assist in the resolution of disputes and give directions to the registered liquidator including ordering them to remedy defaults.<sup>170</sup>

In administrations while the intention of the legislation is to provide a process without the need for court involvement it is possible for the administrators to seek assistance of the court.<sup>171</sup>

For bankruptcy the Federal Court of Australia, the Federal Magistrates Court and the Family Court of Australia all have jurisdiction.<sup>172</sup> The registered trustee may involve the court in any matter particularly to receive directions and there is a general power given to the court to hear any application by any person aggrieved.<sup>173</sup>

### 1.14 Government regulator/supervisor

#### 1.14.1 Government regulator

Corporate insolvency in Australia is regulated by the independent federal government department known as the Australian Securities and Investments Commission (ASIC). They have their own Commonwealth Act, the ASIC Act 2001 (Cth) and they serve the Federal Treasurer. The ASIC Act requires ASIC to maintain, facilitate and improve the performance of the financial system and entities in it, promote confident and informed participation by investors and consumers, administer the law effectively and with minimal procedural requirements, enforce and give effect to the law, receive, process and store, efficiently and quickly, information that they collect and make information about companies and other

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<sup>166</sup> Corporations Act 2001 (Cth) s. 1284.

<sup>167</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 26.

<sup>168</sup> Bankruptcy Act 1966 (Cth) Pt VIII.

<sup>169</sup> *Ex parte James; Re Condon* (1874) LR 9 Ch App 609.

<sup>170</sup> Corporations Act 2001 (Cth) ss. 479(3), 477, 536 and 540(1). See further P. Agardy, 'Applications by Insolvency Practitioners to the Court for Directions' (1999) 7 *Insolvency Law Journal* 60; A. Faunce-de Laune, 'Applications for Directions Pursuant to the Corporations Act: A Guide to Determining When they May Be Successful' (2003) 3(5) *Insolvency Law Bulletin* 81.

<sup>171</sup> Corporations Act 2001 (Cth) ss. 439A(6), 447A.

<sup>172</sup> Bankruptcy Act 1966 (Cth) s. 27.

<sup>173</sup> Bankruptcy Act 1966 (Cth) s. 303.

bodies available to the public as soon as practicable.<sup>174</sup> Additionally, under the ASIC Act there is a corporate law reform body established known as the Companies and Market Advisory Committee (CAMAC) whose primary function is to advise and report to the government on the operation, administration and reform of the Corporations Act 2001 (Cth) and hence, corporate insolvency.<sup>175</sup> Among the relatively recent reports on corporate insolvency that they produced include *Issues in External Administration* in 2008 and the *Report on Rehabilitating Large and Complex Enterprises in Financial Difficulties* in 2004.<sup>176</sup> Also under the ASIC Act there is a requirement that the Federal Parliament appoint a committee known as the Parliamentary Joint Committee on Corporations and Securities. This committee consists of members from both houses of parliament and adds an additional level of parliamentary supervision to that of the Treasurer. The committee is to inquire and report on the operation of the Corporations Act including corporate insolvency. A significant work that this committee reported on was *Corporate Insolvency Laws: A Stocktake* in July 2004.<sup>177</sup>

In bankruptcy the overall responsibility for administration of the Bankruptcy Act 1966 (Cth) rests with the Inspector General in Bankruptcy who is appointed by the Federal Attorney General. The Inspector General heads the Insolvency and Trustee Service Australia (ITSA) which is the federal government agency charged with the administration and regulation of the personal insolvency system in Australia. ITSA's stated purpose is to provide a personal insolvency system that minimises the impact of financial failure on the community, produces equitable outcomes for debtors and creditors and enjoys the public confidence through the application of business laws, regulation and trustee services.<sup>178</sup> The Bankruptcy Act 1966 (Cth) also creates the office of an Official Trustee and an Official Receiver. Functions performed by the Official Receiver include *inver alia* accepting debtors' petitions, issuing bankruptcy notices, examining and investigating bankrupts, lodging objections to discharges of bankruptcy, maintaining the National Personal Insolvency Index.

ITSA is set up with five separate business lines including 'regulation and enforcement' and 'trustee services' amongst them. However, there is a separate Bankruptcy Policy Branch within the federal government's Attorney General's Department that is active in law reform.

#### 1.14.2 Government supervisor

For corporate insolvency ASIC is responsible for the registration of private practitioners who conduct the individual case administrations. No companies' insolvency administrations are conducted by the government regulator.

For bankruptcy the Official Trustee, that is, the government agency, ITSA carries out approximately 85 per cent of all bankruptcy administrations.<sup>179</sup> ITSA is responsible for registering 'registered trustees' who perform the remaining administrations. ITSA performs the

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<sup>174</sup> For information on ASIC refer to <<http://www.asic.gov.au>>.

<sup>175</sup> ASIC Act 2001 (Cth) s. 145.

<sup>176</sup> For details and downloads of CAMAC reports <<http://www.camac.gov.au>>.

<sup>177</sup> <[http://www.aph.gov.au/senate/committee/corporations\\_ctte/reports/index.htm](http://www.aph.gov.au/senate/committee/corporations_ctte/reports/index.htm)>.

<sup>178</sup> <<http://www.itsa.gov.au>>.

<sup>179</sup> In 2009–10 it received 84% (23201) of the new bankruptcy administrations and in 2008–09 it was 86%. Annual report for 2010 available at <[http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/About%20Us-%3EPublications-%3EAnnual%20Report%20Documents%200910/\\$FILE/ITSA\\_Annual\\_Report0910.pdf](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/About%20Us-%3EPublications-%3EAnnual%20Report%20Documents%200910/$FILE/ITSA_Annual_Report0910.pdf)>.

monitoring of practitioner (e.g. registered trustees) standards, investigates complaints and statutory reviews of trustees' decisions.

## 1.15 Creditors

### 1.15.1 Types of creditors

There are essentially four main types of creditors: secured creditors, administration creditors, employee creditors and unsecured creditors.

In all forms of insolvency the secured creditors<sup>180</sup> can choose to stand outside the liquidation administration or bankruptcy and look to their security to recover payment of the debts without needing to play a role in the liquidation or bankruptcy.<sup>181</sup> Secured creditors can prove in the liquidation or bankruptcy and if they do then they must give up their security and prove for the full amount<sup>182</sup> or have their security valued and prove for the difference or as another alternative they can sell the insolvent company's or debtor's property that they have secured and then prove for the difference.<sup>183</sup>

In liquidations the 'administration' creditors and the employee creditors receive a statutory priority in the order of application of assets to pay debts and claims in a winding-up.<sup>184</sup> The debts of a class of creditor rank equally between themselves and must be paid in full, unless the property of the company is insufficient to meet them, in which case they must be paid proportionately.<sup>185</sup> This means that the administration creditors will be satisfied before the employee creditors. There is no further recourse given to administration creditors and if the liquidator becomes aware that even these preferential creditors will not be satisfied he or she may seek the court's directions<sup>186</sup> and of course the court has the power to terminate a winding-up.<sup>187</sup> A liquidator is not liable to incur any expense in relation to the winding-up if there is insufficient available property, although a court could direct the liquidator to incur an expense on the condition that say a creditor indemnifies the liquidator.<sup>188</sup>

The 'administration' creditors include expenses (except deferred expenses) of a relevant authority properly incurred in 'reserving, realising or getting in property of the company, or in carrying on the company's business', costs in respect of the application for the winding-up order including the applicant's taxed costs. Certain debts of the administrator in an administration are given priority in s. 556(1)(c) of the Corporations Act 2001 (Cth). Where the company has been under administration prior to the commencement of the winding-up, costs of auditing the liquidator's account, and other expenses (apart from deferred expenses) properly incurred by a relevant authority are given the next priority.<sup>189</sup> Examples of these expenses are the out-of-pocket expenses and disbursements incurred by a liquidator are the

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<sup>180</sup> Defined in Bankruptcy Act 1966 (Cth) s. 5(1) as a person 'holding a mortgage, charge or lien on property of the debtor as security for a debt due to him or her from the debtor'.

<sup>181</sup> Corporations Act 2001 (Cth) s. 471C.

<sup>182</sup> Corporations Act 2001 (Cth) s. 554E(3).

<sup>183</sup> Bankruptcy Act 1966 (Cth) s. 44(2)-(6). See further C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 40.

<sup>184</sup> Corporations Act (Cth) s. 556.

<sup>185</sup> Corporations Act 2001 (Cth) s. 559.

<sup>186</sup> Corporations Act 2001 (Cth) s. 479(3).

<sup>187</sup> Corporations Act 2001 (Cth) s. 482.

<sup>188</sup> Corporations Act 2001 (Cth) s. 545.

<sup>189</sup> Corporations Act (Cth) s. 556(1)(dd).

employees' wages and other entitlements such as injury compensation, leave and retrenchment payments.<sup>190</sup>

Unsecured creditors will be paid once the liquidator has paid the debts given statutory priority (the secured creditors and the preferential creditors including the administration creditors and the employee creditors), and this balance must be shared rateably among the unsecured creditors.

In administration there are three types of creditors: the secured creditors, the unsecured creditors and the employee creditors. The secured creditors can choose to stand aside from the administration. They do have a provision in the Act (s. 441A) that provides that a secured creditor can decide to enforce their charge within 13 business days after the chargee is given notice of the appointment of an administrator to a company. They do not need to forego their security and be treated as an unsecured creditor and this is meant to increase their likelihood of being involved to assist in the success of the rehabilitation.<sup>191</sup>

The employee creditors are creditors of the company during the administration for their wages and other entitlements and they are entitled to vote in respect of their claims at the meetings of creditors.<sup>192</sup> Greater say has been given to employees who now need to agree to a proposal for a deed of company arrangement where it alters their existing statutory priorities upon liquidation.<sup>193</sup>

Unsecured creditors are provided with the opportunity to attend meetings and decide the future of the company including how much of their debt will be repaid in any reorganisation such as a deed of company arrangement.<sup>194</sup>

In bankruptcy there are also four types of creditors: the secured creditors, the unsecured creditors, the administration creditors and the employee creditors. As in corporate insolvency the secured creditors can stand aside from the insolvency proceedings. Also the Bankruptcy Act 1966 (Cth) requires that each class of creditor be paid in full, or if there are insufficient funds to do so that members of a class share equally, before funds are distributed to the next priority class.<sup>195</sup> The Bankruptcy Act 1966 (Cth) establishes the following order of priorities: the costs of the bankruptcy administration and petitioner's costs such as the taxed<sup>196</sup> costs of the petitioning creditor where the bankruptcy was the result of a creditor's petition, and the costs, charges and expenses of the administration of the bankruptcy. The latter include the remuneration and expenses of the trustee and the costs of any audit carried out on accounts furnished by the trustee to the Registrar.<sup>197</sup> If the bankrupt had signed an authority under s. 188 of the Bankruptcy Act 1966 (Cth) to call a meeting of

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<sup>190</sup> C. F. Symes, 'Remuneration, rent and "requisite" costs: The 3 R's of insolvency's administration expenses priority' (2000) 11 *Australian Journal of Corporate Law* 149.

<sup>191</sup> Corporations Regulations 5.6.24(4); M. Murray and J. Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (2011) para. 22.345

<sup>192</sup> *Brash Holdings Ltd v Katile Pty Ltd* (1994) 12 ACLC 472. See further C. Hammond, 'Are receivers and administrators liable for the wages of company employees retained after their appointment?' (1997) 5 *Insolvency Law Journal* 136; C. Hammond, 'Relationship of administrators to company employees' (1999) 7 *Insolvency Law Journal* 74.

<sup>193</sup> Corporations Act 2001 (Cth) s. 444DA.

<sup>194</sup> Corporations Act 2001 (Cth) ss. 436E, 439C requires meetings of creditors.

<sup>195</sup> Bankruptcy Act s. 109(11); Corporations Act s. 559.

<sup>196</sup> See *Re Hardwick* [1976] Qd R 264; (1976) 13 ALR 641.

<sup>197</sup> Bankruptcy Act 1966 (Cth) s. 109(1)(a). For the accounts which must be furnished see s. 175.

creditors under Part X of the Act (which is an alternative to formal bankruptcy), the costs associated with the s. 188 authority are also given a priority. If the bankruptcy occurred within two months of a personal insolvency agreement under Part X being set aside or terminated then priority is given to liabilities incurred under the agreement that was set aside. If the insolvent estate is that of a deceased debtor whose estate is being administered under the Bankruptcy Act 1966 (Cth) Pt XI, then priority is given to funeral and testamentary expenses.<sup>198</sup> Finally, there is priority for payments to employees and so wages, workers compensation claims, leave entitlements, payments to apprentices and artied clerks all receive priority.<sup>199</sup> A meeting of creditors may decide to give priority to other creditors of the bankrupt.<sup>200</sup>

As bankruptcy is a collective process, creditors such as the unsecured creditors lose their individual rights of action and have them replaced with a right to share in the distribution of the bankrupt's estate.<sup>201</sup> However, unsecured creditors do receive some powers under the Bankruptcy Act 1966 (Cth) such as the power through a meeting to give lawful directions, to appeal to a court on a matter that challenges the trustees' actions and to initiate public examinations of the bankrupt, amongst other rights.<sup>202</sup>

#### 1.15.2 Creditors committee and creditors meetings

In liquidations the creditors can institute a committee of inspection to assist the liquidator. The choice of having a committee is presented to a meeting of creditors by the liquidator or a meeting can be requested by any creditor to contemplate investigating such a committee. A committee must have at least two members but there is no upper limit. Members who are not creditors can be appointed to the committee of inspection. Creditors may appoint a proxy to attend the meeting and vote and creditors who are companies must nominate as a proxy. The committee occupy fiduciary positions and there is no statutory provision for remuneration. The liquidator must have regard to the directions of the committee but the creditors (in meeting, for instance) can override the committee.<sup>203</sup>

During administrations the corporate reorganisation can only take place with the agreement of creditors. There are two compulsory meetings of creditors, the first is to agree to the choice of administrators (or change to another) and whether a committee of inspection will be formed.<sup>204</sup> The second meeting of creditors is held to decide whether the company winds up, enter a period where it is governed by a deed of company arrangement or a third choice of returning to the position it was in prior to the administration with the directors in charge.<sup>205</sup> The committee of creditors' functions include consulting with the administrator about matters relating to the administration and to receive and consider reports of the administrator.

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<sup>198</sup> Bankruptcy Act 1966 (Cth) s. 109(1)(d). Testamentary expenses are those incidental to the proper performance of the executor's duty. *Sharp v Lush* (1879) 10 Ch D 468; *Re Bullock; Ex parte Calder* (1933) 6 ABC 107. They include expenses incurred in relation to proceedings in an administration action: *Re York; Atkinson v Powell* (1887) 36 Ch D 233; 56 LT 704; *Re Chapman; Ex parte Clark* (1894) 71 LT 778; 11 TLR 94.

<sup>199</sup> Bankruptcy Act 1966 (Cth) s. 109(1)(e),(f),(g) and (h).

<sup>200</sup> Bankruptcy Act 1966 (Cth) s. 109(1)(j).

<sup>201</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 66.

<sup>202</sup> Bankruptcy Act 1966 (Cth) ss. 177, 178 and 81. See further, M. Murray and J. Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (2011) para. 6.60.

<sup>203</sup> Corporations Act 2001 (Cth) ss. 479(1), 548, 549 and 551. See further, M. Murray and J. Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (2011) para. 10.105.

<sup>204</sup> Corporations Act 2001 (Cth) s. 436E.

<sup>205</sup> Corporations Act 2001 (Cth) s. 439C.

The first creditors meeting determines the make up of the committee and each member must be either a creditor, attorney of such creditor or be authorised in writing by such a creditor.<sup>206</sup> During the period of administration the committee's decisions would not be binding upon the administrator.<sup>207</sup> If the company entered a deed of company arrangement, the deed could contemplate a committee of inspection and if it did this committee can have a role in approving the administrator's remuneration.<sup>208</sup>

In bankruptcy the creditors can meet and pass resolutions giving lawful directions to the trustee that the trustee shall have regard to and this is the case where the creditors have formed a committee of inspection and they give such a direction.<sup>209</sup> A committee of inspection is optional and if formed its function is to advise and assist the trustee.<sup>210</sup> Only creditors or persons authorised by them may act as members. The committee is made up of between three and five members.<sup>211</sup> The trustee or any member of the committee of inspection can call meetings and proceedings require a majority of members for a quorum and for voting resolutions.<sup>212</sup>

## 1.16 Other stakeholders

### 1.16.1 Employees

In compulsory liquidation the order of the court serves as notice of dismissal to all employees.<sup>213</sup> The liquidator can employ the existing employees for a period during the liquidation and is responsible for their wages. In other liquidations the circumstances can indicate an intention to dismiss. Wages and other employee entitlements enjoy a statutory priority in the distribution of the estate. There is an employee entitlements fund known as the General Employee Entitlements and Redundancy Scheme,<sup>214</sup> which is government funded and the liquidator makes application for amounts from this fund to pay employees and the federal government is then subrogated for the priority distribution.<sup>215</sup> There is no automatic transfer of employment contracts with the sale of business. Although rare, golden parachute and severance packages for executives could be expected to be upheld as a matter of general contract law as there is no express prohibition in the insolvency law.

In administration employees employment contracts are not affected by the appointment of the administrator. The administrator can decide to dismiss employees.<sup>216</sup> These employees have no access to the GEERS fund.

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<sup>206</sup> Corporations Act 2001 (Cth) ss. 436E(1), 436F, 436G.

<sup>207</sup> This is due to the importance placed on the second meeting of all creditors under Corporations Act 2001 (Cth) s. 439C. It is possible for the committee of creditors to approve remuneration see Corporations Act 2001 (Cth) s. 449E(1).

<sup>208</sup> Corporations Act 2001 (Cth) s. 449E(1A).

<sup>209</sup> Bankruptcy Act 1966 (Cth) s. 177.

<sup>210</sup> Bankruptcy Act 1966 (Cth) s. 70.

<sup>211</sup> Bankruptcy Act 1966 (Cth) s. 70(1)(2).

<sup>212</sup> Bankruptcy Act 1966 (Cth) s. 70(6)(7).

<sup>213</sup> *Re General Rolling Stock Co* (1886) 1 Eq 346.

<sup>214</sup> <<http://www.deewr.gov.au/WorkplaceRelations/Programs/EmployeeEntitlements/GEERS/Pages/default.aspx>> (accessed 23 May 2011).

<sup>215</sup> It is expected that the scheme will be legislated for in 2011 in the Fair Entitlements Guarantee Bill.

<sup>216</sup> *Green v Giljohann* (1995) 17 ACSR 518.

In bankruptcy employees can be dismissed by the trustee and they enjoy a statutory priority for their wages and other entitlements in the distribution of the estate. GEERS also applies to employees of bankrupts.

### 1.16.2 Shareholders

In liquidations, shareholders lose any right to control the management of the company's business. Shareholders of companies limited by shares are liable to pay any unpaid amount owing on their shares.<sup>217</sup> Shareholders are prohibited from transferring their shares when their company is in liquidation. The liquidator has the power to consent to a share transfer if it is in the interests of creditors.<sup>218</sup> Section 563A of the Corporations Act 2001 (Cth) provides for the deferral of debts owed to shareholders in their capacity as shareholders (such as an unpaid dividend or a claim that arises from buying the shares) until after all other claims have been satisfied.<sup>219</sup>

In administrations there is a statutory freeze on share transfers.<sup>220</sup> An administrator or the court could permit the transfer of shares but only after considering the interests of creditors and the objects of the administration.<sup>221</sup> There are no other express rights or powers for shareholders in an administration. It is possible that they could qualify as 'interested person' for the purposes of seeking the court's involvement.<sup>222</sup> There is no issue of subordination or termination as their shareholding should be unaffected (apart from the obvious hope for restored or even increased share value).

## E. Effects of the commencement of insolvency proceedings

### 1.17 The effects of the filing versus the effects of the opening judgment

In Australia there is a process known as provisional liquidation. Under s. 472(2) of the Corporations Act 2001 (Cth) an application for a provisional liquidator can be made at any time after the filing of a winding-up application and before the making of a winding-up order or if there is an appeal against a winding-up order then before the decision in the appeal is made. The court will expect that there is a valid and subsisting winding-up application in existence at the time of the hearing of the application to appoint a provisional liquidator.<sup>223</sup> The provisional liquidator can be appointed to a company to maintain the status quo and undertake additional roles in the company pending the winding-up. Provisional liquidators have been appointed to enable a company to complete current contracts or enter into new contracts, and to execute the relevant documents, and to preserve the goodwill and trading activities of the company. A court order appointing a provisional liquidator must state the

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<sup>217</sup> Corporations Act 2001 (Cth) s. 515.

<sup>218</sup> Corporations Act 2001 (Cth) s. 468A.

<sup>219</sup> There has been a recent change to this position by Corporations Amendment (Sons of Gwalia) Act 2010. Note much has been written on this topic recently following *Sons of Gwalia Ltd v Margaretic* (2007) 232 ALR 232, [2007] HCA 1. See for example A. Hargovan and J. Harris, 'Sons of Gwalia: Navigating the line between membership and creditor rights in corporate insolvencies' (2007) 25 *Corporate and Securities Law Journal* 7; D. Pompilio, 'Should claims held by misled and deceived shareholders rank with rather than behind claims held by other unsecured creditors of insolvent companies?' (2009) 27 *Corporate and Securities Law Journal* 426.

<sup>220</sup> Corporations Act 2001 (Cth) s. 437F.

<sup>221</sup> Corporations Act 2001 (Cth) s. 437F(2) (7); *Selim v McGrath* (2004) 22 ACLC 112.

<sup>222</sup> Corporations Act 2001 (Cth) s. 447A(4)(f).

<sup>223</sup> *Re A Company* [1973] 1 WLR 1566.

nature of, and give a short description of, the property of which the appointee is ordered to take possession and specify the duties to be performed by the appointee.<sup>224</sup> Section 471B of the Corporations Act 2001 (Cth) provides, *inter alia*, that while a provisional liquidator is acting a person cannot begin or proceed with a court proceeding against the company or in relation to its property or any enforcement process in relation to the company's property, except by leave of the court and then only within such terms as the court imposes. A provisional liquidation will end when a winding-up order is made and a liquidator is appointed.<sup>225</sup>

In a liquidation by the court, s. 468 of the Corporations Act 2001 (Cth) makes any disposition of property of the company void unless the court orders otherwise and so this has the effect of depriving a company of the power to dispose of its property as from the commencement of winding-up, unless the court approves of the disposition. The liquidation is generally taken to have begun or commenced on the date of the winding-up order, not the date of the filing of the winding-up application.<sup>226</sup>

For administration there is no need to have any space between opening and appointment as it happens instantaneously.<sup>227</sup>

In bankruptcy as a preliminary to becoming bankrupt by s. 55 of the Bankruptcy Act 1966 (Cth), a debtor can file a form known as a declaration of intention to present a debtor's petition.<sup>228</sup> The result is that if the Official Receiver accepts it then there is a stay period beginning on the day of acceptance of the declaration and ending either 21 days later or earlier, if it is either the day the debtor presents a bankruptcy petition, signs a (Part X) personal insolvency agreement or on the day a sequestration order is made, that is steps possible under the Bankruptcy Act 1966 (Cth).<sup>229</sup> The stay used is by the debtor to prevent enforcement action by creditors to whom they owe a debt provable in bankruptcy.<sup>230</sup> Where there is a creditor's petition to bankrupt it is possible for an order to be made before the creditor's petition hearing directing the Official Trustee or a registered trustee to take control of the debtor's property.<sup>231</sup>

### 1.18 Protection and preservation of the insolvent estate

Upon a compulsory liquidation any disposition (including sales) of property by the company is void and the liquidator can expect its return.<sup>232</sup> Dispositions can be validated by the court if such a disposition will assist to preserve the company's business.<sup>233</sup>

If a company is being wound up compulsorily the liquidator must assume custody or take control of all the property to which the company is, or appears to be, entitled.<sup>234</sup> In addition,

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<sup>224</sup> Federal Court (Corporations) Rules 2000 (Cth) r. 6.1(3).

<sup>225</sup> For a detailed discussion of provisional liquidation in Australia see C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) para. 10.1.1–10.1.11.

<sup>226</sup> Corporations Act 2001 (Cth) s. 513A.

<sup>227</sup> Corporations Act 2001 (Cth) s. 435C.

<sup>228</sup> Bankruptcy Act 1966 (Cth) s. 54A.

<sup>229</sup> Bankruptcy Act 1966 (Cth) s. 5(1) defines 'the stay period'.

<sup>230</sup> For greater details see C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) para. 2.5.1.

<sup>231</sup> Bankruptcy Act 1966 (Cth) s. 50.

<sup>232</sup> Corporations Act 2001 (Cth) s. 468(1).

<sup>233</sup> Corporations Act 2001 (Cth) s. 468(3).

<sup>234</sup> Corporations Act 2001 (Cth) s. 474(1).

s. 478(1) of the Corporations Act 2001 (Cth) requires that as soon as is practicable after the court orders that the company be wound up the liquidator must cause the company's property to be collected. There is an expectation upon the liquidator to do everything in his or her power to augment the disposable assets of the company, and they are given various powers for recovering debts owing to the company. The liquidator may obtain, through an application to the court, a summary order for the delivery of books, money or property of the company.<sup>235</sup>

In administration the administrator is the only person who can deal with the company's property.<sup>236</sup>

In bankruptcy the Bankruptcy Act 1966 (Cth) provides the trustee with power to be able to recover property if the debtor disposed of property before becoming bankrupt. The way this is done is by the doctrine of relation back. The date of bankruptcy is the date the sequestration order is made or where the debtor presents his or her own petition then the date is the day on which the petition is accepted by the Official Receiver.<sup>237</sup> However the commencement of the bankruptcy 'relates back' to an earlier time when the bankrupt committed his or her earliest act of bankruptcy within the six-month period immediately preceding the presentation of the creditor's petition.<sup>238</sup> The Bankruptcy Act 1966 (Cth) provides for the protection of genuine commercial transactions that have taken place before the date of bankruptcy but will not be available to the trustee through the use of relation back.<sup>239</sup> The Bankruptcy Act 1966 (Cth) requires the trustee to forthwith take possession of all the property of the bankrupt<sup>240</sup> and various provisions assist the trustee in this task. The bankrupt is required to cooperate<sup>241</sup> and others who hold property or money of the bankrupt are also required to deliver it up to the trustee. If necessary, the trustee may apply to the court for an order enforcing possession.<sup>242</sup>

### 1.19 Assets constituting the insolvent estate

In liquidation there is no automatic vesting of the title to the company's assets into the liquidator's name; however the liquidator is given a statutory power to collect those assets. In a court-appointed liquidation the liquidator must assume custody or take control of all the company's assets.<sup>243</sup> The liquidator also has the power to sell or otherwise dispose of these assets.<sup>244</sup> A court upon application of a liquidator may order the vesting of all or some of the assets.<sup>245</sup> Of course, the principle of separate legal entity is upheld in Australia and so there can be closely related companies and yet the assets of one company in the group will not vest into the hands of a related company's liquidator. The liquidator has the power to disclaim certain property that is of no benefit to the estate.<sup>246</sup>

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<sup>235</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 286.

<sup>236</sup> Corporations Act 2001 (Cth) s. 437D.

<sup>237</sup> Bankruptcy Act 1966 (Cth) s. 57A.

<sup>238</sup> Bankruptcy Act 1966 (Cth) s. 115(1).

<sup>239</sup> Bankruptcy Act 1966 (Cth) s. 123.

<sup>240</sup> Bankruptcy Act 1966 (Cth) s. 129(1).

<sup>241</sup> Bankruptcy Act 1966 (Cth) s. 77.

<sup>242</sup> Bankruptcy Act 1966 (Cth) s. 129(2).

<sup>243</sup> Corporations Act 2001 (Cth) ss. 474, 477.

<sup>244</sup> Corporations Act 2001 (Cth) s. 477.

<sup>245</sup> Corporations Act 2001 (Cth) s. 474(2).

<sup>246</sup> Corporations Act 2001 (Cth) s. 568(1).

In an administration the administrator is granted control over the company's assets.<sup>247</sup> The administrator has the power to dispose of assets but the administrator is only in place for a limited time and it would be unusual to exercise this power.<sup>248</sup> During a deed of company arrangement, the administrator may be given control of the company's assets and the power of sale.<sup>249</sup> At neither stage does the administrator have the assets vested in his or her name.

In bankruptcy the assets held by the debtor at the commencement of the bankruptcy are vested in the Official Trustee or the registered trustee.<sup>250</sup> Furthermore other property acquired by the bankrupt after the commencement and property transferred by the debtor prior to bankruptcy but which is recoverable may be available to creditors.<sup>251</sup> As bankruptcy is designed to provide an opportunity for rehabilitation it is accepted that the bankrupt should be allowed to retain some property. It may also avoid the bankrupt relying on the state social security system. Therefore, there are some exceptions and these assets referred to as 'exempt property' include property held on trust, household property if the property is reasonably necessary for the domestic use of the bankrupt's household (e.g. beds for bankrupt's children), sentimental property as identified in regulations, property used to earn an income by personal exertion (e.g. tools of trade), means of transport (e.g. a car to a specified value), interests in life assurance and superannuation, and rights to certain damages or compensation such as damages for personal injury.<sup>252</sup> The property that constitutes the estate remains subject to any security rights and equities to which it was subject in the hands of the bankrupt.

### **1.20 Divestment of the debtor**

In a company being liquidated the corporate personality and powers of the company do not alter. The liquidator has the power to carry on the company's business yet only until the business is sold as a going concern or the assets can be sold.<sup>253</sup> The liquidator has no power to continue the business with the hope of rescuing the company although the liquidator can commence an administration that would then consider a corporate reorganisation.<sup>254</sup> The company's board of directors are essentially suspended while the liquidator is present in the company. Directors in a voluntary winding-up can be consented to continue with their role<sup>255</sup> and in a creditors' voluntary liquidation a committee of inspection may permit a continued role for the directors.<sup>256</sup> In a compulsory liquidation the directors are suspended and the court may permit a director to exercise some director functions.<sup>257</sup> Directors do retain the power to challenge the appointment of the liquidator.<sup>258</sup>

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<sup>247</sup> Corporations Act 2001 (Cth) s. 437A.

<sup>248</sup> Corporations Act 2001 (Cth) s. 437A(1)(c).

<sup>249</sup> Corporations Act 2001 (Cth) s. 444A(3),(4).

<sup>250</sup> Bankruptcy Act 1966 (Cth) s. 58.

<sup>251</sup> For instance property recovered from undervalued transactions, transfers to defeat creditor or preferences; Bankruptcy Act 1966 (Cth) ss. 120, 121 and 122.

<sup>252</sup> The exemptions are found in Bankruptcy Act 1966 (Cth) s. 116(2) and Bankruptcy Regulations 6.03–6.04.

<sup>253</sup> Corporations Act 2001 (Cth) s. 477(1)(a).

<sup>254</sup> Corporations Act 2001 (Cth) s. 436B.

<sup>255</sup> Corporations Act 2001 (Cth) s. 495(2).

<sup>256</sup> Corporations Act 2001 (Cth) s. 499(4).

<sup>257</sup> Corporations Act 2001 (Cth) s. 471A.

<sup>258</sup> *Rock Bottom Fashion Market Pty Ltd v C E Griffiths Pty Ltd* (1997) 142 FLR 20.

During an administration the directors will not be able to exercise their powers and so the directors' powers are suspended.<sup>259</sup> Directors can participate in the management with the permission of the administrator.<sup>260</sup> In a deed of company arrangement the directors' powers are revived and it is common for the deed to curtail and outline their role.<sup>261</sup> There is an expectation that the company directors will assist the administrator in his or her inquiries.<sup>262</sup>

The bankrupt is under the control of the Bankruptcy Act and so a number of freedoms of the individual bankrupt are restricted.<sup>263</sup> The bankrupt must cooperate with and assist the trustee in bankruptcy and so the exercise of many individual powers are subject to the trustee's approval.<sup>264</sup> For example, the bankrupt is required to give his or her passport to the trustee and so travel can be restricted. A bankrupt can continue to work although certain occupations prohibit bankrupts<sup>265</sup> and a bankrupt is disqualified from managing a corporation (without leave of the court).<sup>266</sup>

### 1.21 Fixation of the position of creditors

In liquidation a liquidator will advertise and invite creditors to prove their claims against the company.<sup>267</sup> Upon receipt of a 'proof of debt' from the creditor that shows how much is claimed the liquidator must then determine to admit or reject the claim. Creditors do not acquire any proprietary interests in the property of the company when it is in liquidation. In compulsory liquidation s. 468(4) of the Corporations Act 2001 (Cth), and in creditors' voluntary liquidation s. 500(1) of the Corporations Act 2001 (Cth), make void any attachment, sequestration, distress or execution put in force against the property of the company after the passing of the resolution to wind up or when the court order is made, that is at the commencement of winding-up.

In an administration it is the function of the administrator to ascertain who are the company's creditors. With the first meeting of creditors being held very shortly after the commencement of the administration the creditors who have been identified by the administrator or those who have come forward generally make up the quorum.<sup>268</sup> Notice of the meeting is published in a national newspaper or a daily newspaper that circulates into the jurisdiction in which the company has its registered office or carries on business.<sup>269</sup> Creditors who have a formal proof of debt admitted by the administrator or who have given particulars of their claim or debts can then vote at these meetings.

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<sup>259</sup> Corporations Act 2001 (Cth) s. 437C.

<sup>260</sup> Corporations Act 2001 (Cth) s. 437C(1A).

<sup>261</sup> *Deputy Commissioner of Taxation v Foodcorp Pty Ltd* (1994) 12 ACLC 508.

<sup>262</sup> Corporations Act 2001 (Cth) s. 438B.

<sup>263</sup> For example Bankruptcy Act 1966 (Cth) s. 77(a)(ii) restricting travel through the giving up of a passport.

<sup>264</sup> Bankruptcy Act 1966 (Cth) s. 77(1)(g) requires the bankrupt to 'aid to the utmost of his or her power in the administration of his or her estate'.

<sup>265</sup> For a complete list <[http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Bankruptcy-%3EFAQ+Documents/\\$FILE/Employment\\_restrictions\\_master.pdf](http://www.itsa.gov.au/dir228/itsaweb.nsf/docindex/Bankruptcy-%3EFAQ+Documents/$FILE/Employment_restrictions_master.pdf)> (accessed 21 May 2011).

<sup>266</sup> Corporations Act 2001 (Cth) s. 206B(3), (4).

<sup>267</sup> Corporations Act 2001 (Cth) s. 553.

<sup>268</sup> Corporations Act 2001 (Cth) s. 436E(3).

<sup>269</sup> Corporations Act 2001 (Cth) s. 436E(3).

In bankruptcy, creditors must lodge a proof of debt and it is required to be in the approved form. Creditors use the form to attach evidence that substantiates their claim. The trustee determines whether to accept or reject the claim. Generally all creditors have a right to claim in the bankrupt estate.<sup>270</sup> Such claims are said to be 'provable'.<sup>271</sup> This broad approach means that future and contingent creditors as well as those with presently existing claims are entitled to a share in the estate.<sup>272</sup> There are three requirements that the claim must meet before it will be provable: (1) it must be enforceable and will not include a claim that is barred by a statute of limitation;<sup>273</sup> (2) it must be capable of being estimated in monetary terms; and (3) the circumstances that give rise to the claim must have occurred before the 'relevant date'.<sup>274</sup>

## 1.22 Pending lawsuits and other proceedings

In liquidations, a person cannot, without the leave of the court, begin or proceed with a court proceeding against the company in relation to its property, or any enforcement process in relation to such property.<sup>275</sup> A court will take into consideration factors such as the amount and seriousness of the claim, the degree of complexity, and the stage the proceedings have reached before allowing the lawsuit to continue. The object of these restrictions is to prevent the assets of an insolvent company being dissipated in wasteful litigation and to oblige creditors to prove their claims in winding-up. It prevents a particular creditor from gaining an advantage over the general body of creditors by proceeding to judgment and execution against the property of an insolvent company. The term 'proceeding' in s. 471B of the Corporations Act 2001 (Cth) includes counterclaims, proceedings for recovery of a

<sup>270</sup> Bankruptcy Act 1966 (Cth) s. 82(1). This subsection is stated to be 'subject to this Division' and so this general principle is qualified by subsequent provisions.

<sup>271</sup> Strictly, an unsecured creditor's claim against a bankrupt is converted from a right of action against into an equitable right to share in the insolvent estate: see generally *Ex parte the Trustee of the Property of Cork (dec'd); Blackburn (Respondent)* (1932) 5 ABC 1; *Re Payne; Heuzenroeder v Trustees* (1934) 7 ABC 127. Summarised from C.F. Symes and J. Duns, *Australian Insolvency Law* (2009).

<sup>272</sup> A future liability is a liability that is not yet due. A contingent claim is one based on an existing obligation which may or may not materialise, depending on whether or not events (which are outside the creditor's control) occur. As pointed out by Tadgell J. in *Federal Commissioner of Taxation v Gosstray* [1986] VR 876 at 878 'a contingent creditor, like an elephant, is rather easier to recognise than define'. See generally *Hardy v Fothergill* (1888) 13 App Cas 351; [1886-90] All ER Rep 597; (1888) 59 LT 273; *Community Developments Pty Ltd v Engwirda Construction Co* (1969) 43 ALJR 365; *Re William Hockley Ltd* [1962] 1 WLR 555; *Re Gasbourne Pty Ltd* (1984) 2 ACLC 103; *Re International Harvester Ltd (Receivers & Managers Appointed)*; *Re International Harvester Credit Corporation of Australia Ltd (Receivers & Managers Appointed)* (1983) 1 ACLC 700 at 703 and *Lyford v Carey* (1985) 3 ACLC 515. A liability under a guarantee, for example, is contingent because it derives from an existing legal relationship but will not arise if the guarantee is not called up. Summarised from C.F. Symes and J. Duns, *Australian Insolvency Law* (2009).

<sup>273</sup> See, for example, *O'Mara Constructions Pty Ltd v Avery* [2006] FCAFC 55; (2006) 151 FCR 196 and generally *Ex parte Ross*; *Re Coles* (1827) 2 Gl & J 330; *Motor Terms Co Pty Ltd v Liberty Insurance Ltd (in liq)* (1967) 116 CLR 177. The limitation period does not run against a claimant during the bankruptcy, at least for the purposes of the bankruptcy proceedings: *Ex parte Ross*; *Re Coles* (1827) 2 Gl & J 330; *Re Benzon*; *Bower v Chetwynd* [1914] 2 Ch 68; (1914) 110 LT 926. See also *Re Amos*; *Ex parte Richardson* (1934) 7 ABC 185; *Re Kongonis (a debtor)* [1964] ALR 567; (1963) 19 ABC 96. Claims based on a foreign revenue debt are also excluded on this basis: *Re Ayres*; *Ex parte Evans* (1981) 34 ALR 582; 51 FLR 395; *Government of India v Taylor* [1955] AC 491. Summarised from C.F. Symes and J. Duns, *Australian Insolvency Law* (2009).

<sup>274</sup> Bankruptcy Act 1966 (Cth) s. 82(1). Legal costs awarded to a creditor are provable if they are incidental to a claim which itself is provable or if they are awarded against the debtor, before the date of bankruptcy, in respect of an action taken by the bankrupt against the creditor: *Re British Gold Fields of West Africa* [1899] 2 Ch 7; (1899) 80 LT 638. Bankruptcy Act 1966 (Cth) s. 5(1). Summarised from C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 141-50.

<sup>275</sup> Corporations Act 2001 (Cth) ss. 471B, s. 500(2).

statutory penalty, starting an action against property, establishing a lien, and arbitration proceedings against the company.

In administrations there is an important moratorium provided by the legislation to prevent distraction from the corporate reorganisation. No civil proceedings can be brought against the company unless the administrator gives written consent<sup>276</sup> or the court grants leave. For proceedings that are already 'on foot' the court can permit an enforcement action but generally the policy of assisting the investigation into the company's future without impediment from pending lawsuits will be upheld.<sup>277</sup> If the company then enters a deed of company arrangement there is no statutory moratorium and such ongoing actions would continue. Although it should be noted that if these claims were related to creditors (and their debts) then the matter may have been resolved and incorporated into the 'rescue' package that has been voted on and implemented with creditors' approval as part of the deed.

In bankruptcy there is a moratorium, essentially a stay, on legal proceedings against the bankrupt. The creditor's right to sue the bankrupt is converted into a right to prove against the insolvent estate. Section 58(3) of the Bankruptcy Act 1966 (Cth) provides that it is not competent for a creditor to enforce any remedy against the person or property of the bankrupt in respect of a provable debt nor is it competent for a creditor to commence any legal proceeding in respect of a provable debt or take a fresh step in such a proceeding without the court's permission. A 'remedy' includes a means of enforcement of a judgment or order. Secured creditors and their rights are not affected and so they can realise their security or deal with it in the ways agreed to in the security documentation.<sup>278</sup> The right to bring legal proceedings will, on a person's bankruptcy, generally vest in the trustee in bankruptcy.<sup>279</sup> Existing civil proceedings already commenced by the debtor prior to bankruptcy will be subject to an automatic stay.<sup>280</sup> This stay does not prevent the trustee commencing fresh proceedings in the trustee's own name however. The stay against the bankrupt does not apply in two situations; (1) where the trustee in bankruptcy elects to proceed with the bankrupt's action,<sup>281</sup> and (2) where a bankrupt has commenced an action in respect of personal injury or wrong to the bankrupt, the bankrupt's spouse or a member of the bankrupt's family or in respect of the death of a spouse or family member.<sup>282</sup> Also in the Bankruptcy Act 1966 (Cth) s.119 reinforces the earlier sections by requiring that a relevant court officer stop further execution processes once he or she has received notice of a creditor's petition, or a debtor's petition that has been referred to the court. This means that a person charged with the execution of a writ or other process<sup>283</sup> shall not proceed and a court registrar or official can take no further

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<sup>276</sup> Corporations Act 2001 (Cth) s. 440D.

<sup>277</sup> W. Robinson, 'Statutory Moratorium on Proceedings Against a Company' (1996) 24 *Australian Business Law Review* 429.

<sup>278</sup> Bankruptcy Act 1966 (Cth) s. 58(5).

<sup>279</sup> Bankruptcy Act 1966 (Cth) s. 58(1).

<sup>280</sup> Bankruptcy Act 1966 (Cth) s. 60(2).

<sup>281</sup> This is provided for in Bankruptcy Act 1966 (Cth) s. 60(2). A party to the proceedings may require the trustee to elect whether to continue the proceedings. The trustee is deemed to have abandoned the action if no election is made within 28 days of service—Bankruptcy Act 1966 (Cth) s. 60(3).

<sup>282</sup> Bankruptcy Act 1966 (Cth) s. 60(4). If the proceedings involve matters both within this exception and outside it, only those proceedings within the exception may be continued by the bankrupt.

<sup>283</sup> The section refers to a 'sheriff'; this is defined to include any person charged with the execution of a writ or other process: Bankruptcy Act 1966 (Cth) s. 5(1).

action in pursuance of the execution or in respect of any money paid into court until the bankruptcy petition has been dealt with by the court or has lapsed.

### 1.23 The impact on contracts

The opening of a liquidation does not automatically terminate contracts and they continue to operate until the liquidator performs, repudiates or disclaims them.<sup>284</sup> If the terms of the contract contemplated that the contract would terminate upon liquidation then that term would be upheld. The court may make an order against the company to the effect that a contract is discharged with or without payment for non-performance or that the contract is rescinded with or without terms as to restitution.

Winding-up has no immediate effect on contracts with the company and therefore contracts could be expected to continue in force until the liquidator performs or repudiates. As with much of contract law the outcomes will depend upon the nature and terms of the contract and the surrounding circumstances. In the rare case where the continued existence of the company or its business can be regarded as an implied condition of the contract, winding-up may cause a frustration of the contract. Usually, however, the company's contracts continue until repudiated by the liquidator or disclaimed by him or her under s. 568 of the Corporations Act 2001 (Cth).

The court's power to make an order for the discharge or rescission of a contract under s. 568(9) of the Corporations Act 2001 (Cth) is not confined to the case where neither party has performed the contract and enforcement of it against the other party would leave him or her with only a right to prove for damages in the winding-up.

In an administration there is no automatic termination of contracts. The appointment of an administrator does not show the company's intention to repudiate any existing contracts nor does it mean that the company will be in breach or repudiating contracts already in existence.<sup>285</sup> The government had considered providing that a contracting party not terminate a particular contract given the circumstances of the company seeking reorganisation; however, this has not been implemented.<sup>286</sup> The administrator could approach the court for assistance in keeping a contract 'on foot'.<sup>287</sup>

In bankruptcy there is no automatic termination of contracts. As the bankrupt's property vests in the trustee therefore this will generally include contractual rights and the trustee will be able to enforce these rights.<sup>288</sup> A bankrupt's property includes choses in action and so will generally include contractual rights. In the case of executory contracts, where both parties to the contract have outstanding obligations, the trustee may not be able to insist on performance by the other party unless the trustee is also in a position to perform.<sup>289</sup>

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<sup>284</sup> Corporations Act 2001 (Cth) s. 568.

<sup>285</sup> *Smith v DCT* (1996) 22 ACSR 331.

<sup>286</sup> M. Murray and J. Harris, *Keay's Insolvency: Personal and Corporate Law and Practice* (2011) para. 22.90.

<sup>287</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 248.

<sup>288</sup> Bankruptcy Act 1966 (Cth) s. 58.

<sup>289</sup> C.F. Symes and J. Duns, *Australian Insolvency Law* (2009) 68.

## 1.24 Other effects of the commencement of insolvency proceedings

### 1.24.1 Exclusive power to invoke avoidance actions/the Actio Pauliana

Liquidators are given power to challenge transactions.<sup>290</sup> Where a company has entered into a transaction any time over the last 10 years and the purpose was to defeat, delay or interfere with the rights of any or all of its creditors then the liquidator upon proving insolvency can seek to void the transaction.<sup>291</sup>

In administration there is limited time to challenge but if the administrator finds a past indiscretion they must report.<sup>292</sup>

In bankruptcy the trustee is given the power to challenge pre-bankruptcy transactions that amount to fraudulent conveyances. The trustee must show that there was a transfer of property, and if that property had not been transferred it would have probably become part of the bankrupt's estate available to be divided amongst creditors and that the main purpose in transferring the property was either to prevent, hinder or delay the property's division amongst creditors.<sup>293</sup> Importantly the trustee does not have to show an intent to defraud. Creditors can challenge transfers of property made with intent to defraud creditors under state conveyancing and property laws.

### 1.24.2 Right to open correspondence

The right to open correspondence is unknown in Australia and therefore in insolvency the question of giving up this right to another person has little importance. In liquidation and administration there is no express right to open correspondence. All companies will have a registered office from registration and this address is where all notices will be received.<sup>294</sup> The registered office is the address where any document may be served either by leaving at this address or posting to it. Where a liquidator or administrator has been appointed then a document is served if it is left at or posted to them.<sup>295</sup> In liquidation the liquidator takes control of the company's property including its books and does so as agent; consequently he or she would be entitled to the correspondence if it were considered 'property' of the company.<sup>296</sup>

In administration the administrator is given power over correspondence indirectly as the administrator has control over the business, property and affairs of the company<sup>297</sup> but not legal title to the property. The administrator acts as agent<sup>298</sup> and would therefore be expected to open correspondence.

In bankruptcy there was a previous statutory provision to permit the trustee to apply to the court for a direction that all postal articles and telegrams addressed to the bankrupt be redirected to the trustee; however it was repealed in 1996.<sup>299</sup> In bankruptcy all property other

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<sup>290</sup> A. Keay, 'Challenging fraudulent transactions and unfair loans as voidable preference transaction' (1995) 2 *Deakin Law Review* 53.

<sup>291</sup> Corporations Act 2001 (Cth) s. 588FE(5).

<sup>292</sup> Corporations Act 2001 (Cth) s. 438D.

<sup>293</sup> Bankruptcy Act 1966 (Cth) s. 121.

<sup>294</sup> Corporations Act 2001 (Cth) s. 121.

<sup>295</sup> Corporations Act 2001 (Cth) s. 109X(1).

<sup>296</sup> Corporations Act 2001 (Cth) s. 474(1).

<sup>297</sup> Corporations Act 2001 (Cth) s. 437A.

<sup>298</sup> Corporations Act 2001 (Cth) s. 437B.

<sup>299</sup> Bankruptcy Act 1966 (Cth) s. 79 and Bankruptcy Rules r. 45A, Form 20A all repealed.

than exempt property vests with the trustee<sup>300</sup> so if correspondence is interpreted as ‘property’ then it would not be an issue for the trustee to open the correspondence. Furthermore, all books that are in possession of the bankrupt must be given to the trustee<sup>301</sup> and the definition of ‘books’ includes ‘any account, deed, paper, writing or document and any record of information however compiled, recorded or stored, whether in writing, on microfilm, by electronic process or otherwise’.<sup>302</sup> Presumably then, correspondence will be characterised as required to be given to the trustee.

#### 1.24.3 Mobility constraints on the debtor<sup>303</sup>

The court has the power under the Corporations Act 2001 (Cth)<sup>304</sup> to prohibit an officer or employee of the company in liquidation from taking or sending money or other property out of the Australia and to surrender their passport and to prohibit them from leaving the country without the court’s consent. An intentional or reckless contravention of this can result in a fine and imprisonment.<sup>305</sup> They can be prohibited from leaving Australia by a court if that court is satisfied that the officers or employees will become liable to pay money to the company with respect to debts or to account for property of the company.<sup>306</sup> The court is also required to be satisfied that there is substantial evidence that the officer or employee has concealed or removed money or other property, has tried to or intends to.<sup>307</sup> Alternatively the court is required to be satisfied that there is substantial evidence that the officer or employee has tried to leave Australia or intends to.<sup>308</sup> The court then contemplates if it is necessary or desirable for the order to be made to protect the company’s rights against the officer or employee.<sup>309</sup> A contravention of the court order with an element of recklessness or intention can attract a maximum penalty of two years’ imprisonment and \$11,000 fine.<sup>310</sup>

In administration there are no mobility constraints upon directors or officers. It is open for the administrator to approach the court to seek an order that the directors assist with the administration and so it is possible for them to be ordered to remain in Australia to assist.<sup>311</sup> Additionally, there is a general power under the Corporations Act 2001 (Cth) for the corporate regulator to seek a court order requiring a person to deliver up to the court their passport if there is an investigation, prosecution or civil proceeding on foot.<sup>312</sup>

Upon bankruptcy, the bankrupt, unless prevented by illness or other sufficient cause or excused by their trustee, is required to give his or her passport to the trustee in bankruptcy.<sup>313</sup>

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<sup>300</sup> Bankruptcy Act 1966 (Cth) s. 58(1).

<sup>301</sup> Bankruptcy Act 1966 (Cth) s. 77(1)(a)(i).

<sup>302</sup> Bankruptcy Act 1966 (Cth) s. 5.

<sup>303</sup> *Official Receiver v Henn* [1982] VR 362; (1981) 40 ALR 569; 61 FLR 410.

<sup>304</sup> Corporations Act 2001 (Cth) s. 486A.

<sup>305</sup> Corporations Act 2001 (Cth) s. 486A(8) presently 100 penalty units (\$A11,000) or two years’ imprisonment or both.

<sup>306</sup> Corporations Act 2001 (Cth) s. 486A(1)(c),(d), (2)(b).

<sup>307</sup> Corporations Act 2001 (Cth) s. 486A(2) (c)(i).

<sup>308</sup> Corporations Act 2001 (Cth) s. 486A(2)(c)(ii).

<sup>309</sup> Corporations Act 2001 (Cth) s. 486A(2)(d).

<sup>310</sup> Corporations Act 2001 (Cth) s. 486A(8).

<sup>311</sup> For example directors are to help the administrator; Corporations Act 2001 (Cth) s. 438B.

<sup>312</sup> Corporations Act 2001 (Cth) s. 1323(1)(j).

<sup>313</sup> Bankruptcy Act 1966 (Cth) s. 77(a)(ii).

A bankrupt who leaves Australia without the written consent of the trustee, or who does an act preparatory to leaving Australia, commits an offence.<sup>314</sup>

This places major mobility constraints on the debtor particularly given the location of Australia to the rest of the world. A bankrupt can seek consent of their trustee to travel beyond Australia and this consent can be given subject to conditions such as payments of income contributions to the estate. A bankrupt may move address in Australia but must inform the trustee in writing immediately of his or her change of particulars and a failure to do so can result in up to six months' imprisonment.<sup>315</sup>

## F. Conversion and termination of insolvency proceedings

### 1.25 Conversion of the type of proceedings

A company in liquidation could move to being a company under administration (the corporate rescue proceeding). The Corporations Act 2001 (Cth) provides that a liquidator or provisional liquidator may by writing appoint an administrator if he or she thinks that the company is insolvent and, by implication, that it should not be liquidated but rescued.<sup>316</sup> They cannot appoint themselves without a creditors meeting passing a resolution approving the appointment.<sup>317</sup>

A company under administration could move to being liquidated if the creditors decide that the company should be wound up at their compulsory meeting.<sup>318</sup> A resolution to wind up is deemed to have been passed and there is deemed to be no declaration of solvency.<sup>319</sup>

A court could form the opinion that it is appropriate for a company under administration to be liquidated.<sup>320</sup> This will occur when a deed of company arrangement is set aside or declared void.

### 1.26 Dissolution of the debtor

A corporate debtor who is liquidated will not automatically be dissolved as an entity. If the company has been compulsorily wound up and the liquidator has made a final dividend to creditors then the liquidator can apply for a release from liability and for an order that the corporate regulator, ASIC, deregister the company.<sup>321</sup> A company, director or liquidator can make application to deregister voluntarily<sup>322</sup> and ASIC can initiate a deregistration.<sup>323</sup> ASIC, as the government regulator, has power to deregister companies and they will do so if they are approached voluntarily (e.g. by the company), or when the court has ordered the deregistration or upon their belief that the company is being wound up or has been wound up and six months has elapsed. Before ASIC will deregister a company of their own volition

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<sup>314</sup> Bankruptcy Act 1966 (Cth) s. 272(c). Under s. 272(2) the trustee can impose conditions on consent, including payment of income contributions if there is a liability for these.

<sup>315</sup> Bankruptcy Act 1966 (Cth) s. 80.

<sup>316</sup> Corporations Act 2001 (Cth) s. 436B.

<sup>317</sup> *Re Depsun Pty Ltd* (1994) 13 ACSR 644.

<sup>318</sup> Corporations Act 2001 (Cth) s. 439C(c).

<sup>319</sup> Corporations Act 2001 (Cth) s. 446A.

<sup>320</sup> Corporations Act 2001 (Cth) ss. 445D, 445G.

<sup>321</sup> Corporations Act 2001 (Cth) ss. 481(3), 480(d), 601AC(1)(b).

<sup>322</sup> Corporations Act 2001 (Cth) s. 601AA.

<sup>323</sup> Corporations Act 2001 (Cth) s. 601AB.

they will send notices to the company, liquidator, directors and into the public arena (through their database and the Government Gazette) and then proceed to deregister after two months.

### 1.27 Conclusion of insolvency proceedings

In a compulsory (court-appointed) liquidation the liquidator may apply to the court for an order to deregister the company as the winding-up process is complete.<sup>324</sup> In a voluntary winding-up the liquidator calls a meeting of the company's members and in a creditors' voluntary liquidation the meeting will be of the company's creditors. At this meeting the liquidator reports that the process has finished, accounts are provided and a final return is then lodged with ASIC.<sup>325</sup> ASIC then deregisters the company at the end of three months subsequent to the lodging of the return.<sup>326</sup> All debts of the company will be discharged as part of the liquidation. It is possible in a liquidation that once completed and the company is deregistered that assets could be discovered and then the company would have to be reinstated.<sup>327</sup> ASIC can reinstate the registration of the company if a court is satisfied that it is just to reinstate and one reason that has been successfully pleaded is the recovery of previously unrecovered assets.<sup>328</sup> Should a company be reinstated it is taken to have continued in existence as if it had not been deregistered.<sup>329</sup>

A company under administration will have at least two creditors meetings. At the second or later meeting the creditors receive a report from the administrator expressing an opinion as to the future of the company.<sup>330</sup> At the meeting the creditors will consider three options: to liquidate, to enter a deed of company arrangement or return the company to its previous management. If the company's creditors choose to return the company back to the directors this will close the proceeding. If the creditors choose a deed then this administration stage will close and the company will enter a new stage of being under a deed of company arrangement.<sup>331</sup> If the company's creditors choose to liquidate then the administration proceeding will close and a liquidation will begin.<sup>332</sup> For companies who enter a deed of company arrangement the deed releases the company from the debt only in so far as the deed provides for that release and the creditor is bound by the deed.<sup>333</sup> Therefore, the creditors can agree to receive a partial payment as full settlement of their debts. If additional assets are discovered after the second meeting (s. 439A meeting) where the creditors decide to support a deed of company arrangement then there could be a further meeting of creditors that could agree on different terms of the deed (a variation) or to liquidate.<sup>334</sup>

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<sup>324</sup> Corporations Act 2001 (Cth) s. 480, although as many of these liquidations have few assets a liquidator is reluctant to spend limited resources on an application to the court.

<sup>325</sup> Corporations Act 2001 (Cth) s. 509.

<sup>326</sup> Corporations Act 2001 (Cth) s. 509(6).

<sup>327</sup> Corporations Act 2001 (Cth) s. 601AH.

<sup>328</sup> A. Keay, 'Deregistration: The new end of the road for companies in liquidation' (1999) 7 *Insolvency Law Journal* 87; C. Symes, 'Top 7 reasons for reinstatement—exhuming the corporate body' (2007) 7 *Insolvency Law Bulletin* 114.

<sup>329</sup> Corporations Act 2001 (Cth) s. 601AH(5).

<sup>330</sup> Corporations Act 2001 (Cth) s. 439A(4).

<sup>331</sup> C. Anderson, 'Ending a means to an end: transition from the voluntary administration process to a deed of company arrangement or liquidation' (2004) *University of Tasmania Law Review* 15.

<sup>332</sup> Corporations Law 2001 (Cth) s. 446A.

<sup>333</sup> Corporations Act 2001 (Cth) ss. 444H, 444D(1).

<sup>334</sup> Corporations Act 2001 (Cth) ss. 445E, 445F.

In bankruptcy there is an automatic discharge after three years from the time the debtor lodges his or her statement of affairs (a lodgement is expected shortly after the commencement of the bankruptcy).<sup>335</sup> The discharge releases the bankrupt from all provable debts.<sup>336</sup> It is possible for the trustee to apply to have the period of bankruptcy extended to five or even eight years if there have been circumstances that trigger the extension.<sup>337</sup> A bankrupt continues to be liable to perform duties imposed by the Bankruptcy Act 1966 (Cth) even after discharge and this includes the duty to assist the trustee to realise and distribute property and to attend examinations.<sup>338</sup> In all states in Australia there are Partnership Acts and there is a provision in these acts that states that a partnership will dissolve upon the bankruptcy of one of the partners.<sup>339</sup> It is possible to have a partnership agreement (in most cases it is a written document) that expresses the will of the partners in the partnership that it continue despite the bankruptcy of one of the partners. The Bankruptcy Act 1966 (Cth) permits second and later (subsequent) bankruptcies.<sup>340</sup> If a trustee in bankruptcy were to discover assets following the bankruptcy they could seek to have the bankrupt charged with failure to make proper disclosure, making false declarations of their affairs and require the discharged bankrupt to explain these assets.<sup>341</sup>

<http://www.pbookshop.com>

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<sup>335</sup> Bankruptcy Act 1966 (Cth) s. 149.

<sup>336</sup> Bankruptcy Act 1966 (Cth) s. 153.

<sup>337</sup> Bankruptcy Act 1966 (Cth) ss. 149C, 149D.

<sup>338</sup> *Re Balborn; Ex parte Balborn* (1981) 39 ALR 223.

<sup>339</sup> For example, Partnership Act 1895 (SA) s. 33.

<sup>340</sup> Bankruptcy Act 1966 (Cth) s. 59.

<sup>341</sup> Bankruptcy Act 1966 (Cth) ss. 265(1)(4), 267, 81, 152.