

A Second Chance through Voluntary Administration?

Clive Lee, Truman Hoyle Lawyers

There is an unfortunate stigma which attaches to companies under external administration – it is as if the words “administrator appointed” signify that a company is not only insolvent, but beyond all hope of rescue and surely on its way out. While a company must obviously be in a grave financial state to warrant the appointment of an administrator, it should be appreciated that insolvency and the complete failure of a business are not necessarily one and the same. It is often the case that an insolvent business cannot be rescued from failure, but in many cases, the appointment of an administrator can provide a business with an opportunity to start afresh.

With this in mind, company directors should regard the appointment of an administrator not as a sign of failure or defeat, but as a potential means for giving the business an invaluable second chance. Even if the company and the business are not capable of being salvaged, voluntary administration will at least result in the quick resolution of the company’s future in most cases. This article will provide a brief overview of the voluntary administration process, and more importantly, what businesses can stand to gain if they are ultimately forced to consider administration as an option.

What is involved in a Voluntary Administration?

When a company voluntarily appoints an administrator, that administrator assumes full control over the company’s affairs, assesses the financial state of the company reports back to the company’s creditors about whether the company is capable of continuing to do business. The objective of a voluntary administration is to maximise the chances of the company being able to continue to exist and to do business, or if that is not possible, to procure a better return for the company’s creditors than the creditors would otherwise receive if the company were immediately wound up.

There are three possible outcomes of a voluntary administration:

1. **The execution of a Deed of Company Arrangement between the company and its creditors.** A deed of company arrangement (DOCA) is essentially a binding agreement between the company and its creditors which sets out how the company’s debts are to be repaid (whether completely or in part) and how the company is to be released from the claims of its creditors; or
2. **The control of the company is returned to the directors.** If it transpires at the end of the administration that the company is solvent, the creditors may resolve to end the administration in this manner and return control to the company’s directors; or
3. **The company is wound up.** If no DOCA is proposed or if the creditors of the company do not resolve to either enter into a proposed DOCA or return the control of the company to the directors, then the creditors must resolve to wind up the company.

While the administrator is required to give his or her opinions on the viability of the above scenarios, it is the creditors who ultimately determine the company's future by resolving to either enter into a DOCA, end the administration or wind the company up.

Given the unlikelihood that the creditors will resolve to return the control of the company to the directors, the execution of a DOCA is generally accepted as a positive outcome for the company. A DOCA can effectively be a second chance for the company and allow the company to take the time to pick itself up and try to trade its way out of its current predicament. The DOCA can also release the company from its debts and pave the way for a fresh start.

When might directors need to consider appointing an Administrator?

One of the key duties imposed upon company directors by the *Corporations Act 2001* is to prevent the company from trading whilst insolvent (that is, if the company is unable to pay its debts when they fall due). A director who fails to act quickly when he or she realises that the company cannot pay its debts when they fall due faces significant civil penalties (up to \$200,000), criminal charges, civil damages and may be banned from acting as a company officer-bearer in the future.

If a company is insolvent, the director of that company must not incur any further debts, and the options available to that director are ordinarily to refinance or restructure the business, or to voluntarily appoint an administrator or a liquidator.

There are several tell-tale signs that a company may be in financial difficulty and either insolvent or approaching insolvency. These include poor cash flows, persistent losses, increasing debt, the receipt of demands against the company (particularly from the ATO) and difficulty obtaining finance.

The Advantages and Disadvantages of Voluntary Administration

Despite the stigma which is often associated with administration, the appointment of an administrator can actually provide numerous and considerable benefits, the most significant of these being the opportunity to save the business and the protection of the company's directors against personal liability for insolvent trading.

The key advantages of a voluntary administration are that:

- **A moratorium is imposed over the company's debts.** The appointment of a voluntary administrator imposes a debt moratorium for the term of the administration. This moratorium period is, subject to certain exceptions, for up to 30 business days.
- **The company can be given a second chance.** During the moratorium, the administrators must report to the creditors and may propose a DOCA. The effect of a DOCA is that the company is permitted a certain period of time in which it must repay its creditors. A DOCA may also involve a compromise, which means that the creditors effectively agree to accept a lesser amount than they are owed by the company. If the creditors of a company resolve to execute a DOCA (as opposed to placing the company into liquidation), then the company will be afforded a second chance to either get back on its feet and try to trade its way back into the black, or be released from its existing debts and start afresh.

- **The directors are protected from liability for insolvent trading.** In a voluntary administration, the administrator assumes the responsibility for all decisions made and all liabilities incurred during the administration process. Hence the risk that the directors will be liable for insolvent trading is shifted to the administrator during the administration process.
- **Court proceedings cannot be commenced or continued against the company,** except with the consent of the administrator or the leave of the Court. This “stay” of court proceedings affords the company and the directors valuable breathing space and time to focus upon the salvaging of the company rather than any claims which the creditors of the company may bring.

There are, of course, disadvantages which are associated with voluntary administrations and some of these are that:

- **Control of the company is relinquished to the administrator.** While this provides certain benefits to the directors of a company, such as protection from personal liability for insolvent trading, the director will not be able to influence the affairs of the company during the administration process. This is because the administrator does not act “for” the directors of a company, even where that administrator is voluntarily appointed by the directors. The administrator’s duty is to the company’s creditors not the directors, and the administrator is under a duty to investigate a directors’ actions and report on whether the director has engaged in any improper business conduct.
- **There is no guarantee of a positive outcome.** Not all businesses can be saved, and if a DOCA is not approved by the creditors, then the company must be placed into liquidation. The upside of this is that the company’s fate will be resolved fairly quickly, and this will allow the directors to move on from the company and pursue other business ventures or interests.
- **The company may suffer various unwanted effects of administration.** These unwanted effects could include, for example, future difficulty in obtaining finance or finding that suppliers of the company only wish to deal with the company on a cash-upfront basis.

The Option of Voluntary Administration

If you suspect that your company may be in significant financial difficulty, or that your company may be approaching insolvency, then it is time to act. The sooner that the directors of a company recognise a problem and take positive steps to address that problem, such as obtaining professional financial and legal advice, the more options they make available to the company and the less likely they are to run afoul of liability for insolvent trading.

While most company directors would shudder at the thought of declaring their company insolvent and appointing an external administrator, voluntary administration should not be seen as a sign of failure or be construed as an admission of defeat. Instead, voluntary administration should be regarded by directors as a means of resolving the fate of their companies quickly and expeditiously, and in many cases, an opportunity to get a business back on track and out of its current predicament.

Clive Lee
Lawyer
Truman Hoyle Lawyers
clee@trumanhoyle.com.au
Tel: (02) 9226 9888
Fax: (02) 9226 9899

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