

CLAYTON UTZ

Restructuring & Insolvency
Provisional liquidation



What is it?

The aim of provisional liquidation is to ensure that the assets of a company are preserved prior to the making of a winding up order.

It differs from other winding up procedures in that it is not concerned with maximising the assets available for distribution among creditors, but is simply an interim procedure aimed at preserving the status quo until a winding up order is made.

It is also different from voluntary administration, as provisional liquidation usually contemplates the winding up of the company. Voluntary administration, however, looks to the possible survival of the company.

Who needs it?

Provisional liquidation is an attractive option where a winding up application has been made and the parties are:

- concerned that the assets of the company will disappear before the winding up order is made; and/or
- believe that it is necessary to shift control of the company away from the directors in the interim.

The option of provisional liquidation will therefore be of interest to unsecured creditors since it will act to preserve the assets that creditors may be entitled to once the winding up order has been made.

However, it is also attractive to the company and its directors where there are concerns that further liability will be incurred in the period between the winding up application and the winding up order, as control and liability effectively will shift from the directors to the provisional liquidator.

What are the requirements?

Generally, in order to apply for provisional liquidation it is necessary that a winding up application be filed. Once this requirement is met it is in the court's discretion whether or not to appoint a provisional liquidator.

Generally though, a court will not approve the application unless it is likely that a winding up order will be made. Further, there is a reluctance to appoint a provisional liquidator unless there are special reasons requiring the appointment to be made; e.g. the assets must face a high risk of dissipation or there must be some other urgent reason why a liquidator is required for the interim period.

It is easier to obtain an order appointing a provisional liquidator where the company itself applies for the order, especially where the decision to apply is made at a general meeting. The company will generally need only show that it has a genuine reason for making the application.

Where the application is likely to be refused

As there must be some special urgency or risk of dissipation of assets, applications have been refused, for example, where:

- the only reason relied on by a creditor was that the company was insolvent
- a receiver and manager had already been appointed, as this negated the risk to the assets
- the application was made to maximise the applicant's own position
- the applicant merely made assertions that the company's accounts were invalid, particularly where there were alternative means available for their examination
- the application was made to permit the company to continue to trade where the company clearly should have been wound up
- there was a genuine dispute as to the creditor's debt.

Where the application is likely to be granted

In contrast, circumstances in which applications have been granted include, where:

- it was necessary to have an independent person investigate the company
- there was an urgent need to examine the nature of the claims of the company by someone other than the directors
- there was an urgent need to act to preserve contracts of possible benefit to the company
- there was a material conflict of interest between a director and the company
- the company's affairs had been so casual and irregular in the past that there was little confidence that the affairs would be properly conducted in the future.

What can the provisional liquidator do?

Generally, a provisional liquidator has the power to carry on the business of the company and has most of the powers of an official liquidator. However, as the purpose of the provisional liquidation is to preserve rather than distribute the company's assets, the provisional liquidator does not have the power to do "all such things as are necessary for winding up the affairs of the company and distributing its property" and is expected to exercise his powers in a way that preserves the assets of the company.

This does not mean, however, that the assets of the company can never be sold. For example, assets could be sold if the point of selling the particular assets can be said to preserve the assets of the company overall.

How does it work?

The appointment displaces the power of the directors, even though they may oppose the winding up application or appeal the winding up order. The situation is more complex where a receiver has already been appointed under a charge to carry on the business of the company – whether or not the provisional liquidator or the receiver carries on the business of the company depends on both the terms of the order appointing the provisional liquidator and the terms of the charge.

As a general rule though, it is considered undesirable to give the provisional liquidator the power to carry on the business of the company where the receiver is in fact doing so already, as to do so would create a potential conflict.

Alternative

As directors can obtain protection by appointing an administrator, provisional liquidation is becoming rarer for company-initiated regimes.

Summary

Provisional liquidation is a means by which the company's assets can be preserved pending the completion of winding up proceedings. The appointment of a provisional liquidator may be desirable where an application for a winding up order has been made and creditors are concerned that the activities of the company and its directors will result in available assets being dissipated in the interim period. Directors may also find it a useful tool, particularly where they are concerned that they will be exposed to liability in the interim period.

There are prerequisites for the appointment of a provisional liquidator. Consequently, if it is believed that the appointment of a provisional liquidator is appropriate for the circumstances, it is important to ensure that care is taken in approaching the courts and that the possible implications of the application are fully understood.

Restructuring & Insolvency group publications

The Restructuring & Insolvency group of Clayton Utz has prepared a series of brochures that provide an outline of the operation of relevant areas of law.

The complete set of brochures in the series comprises:

- Deed of company arrangement
- Company receivers and managers
- Third party guarantees
- Retention of title clauses
- Voluntary administration
- Liquidation
- Provisional liquidation
- Enforcing security rights

Treatment of the topic addressed in each brochure though comprehensive is not exhaustive. Moreover, a proper understanding of any particular situation demands an integrated approach. Clayton Utz is available to give advice over the whole range of issues relating to corporate restructuring and insolvency, including the position of secured and unsecured creditors, and the practical issues relating to enforcement of securities and debt recovery, structuring and restructuring transactions and litigation.

Copies of this brochure and the others referred to can be obtained free of charge from the Restructuring & Insolvency group of Clayton Utz.

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