

Pre-Liquidation Sale of Assets

Tricks and Traps



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Pre-Liquidation Sale of Assets

This Information Sheet is designed to provide Advisers with general advice regarding the transfer of assets in the situation where a company is insolvent or potentially insolvent.

Be aware that this is a particularly tricky area of the law and we recommend that specific advice be sought in each circumstance.

You may also be interested in our separate Information Sheet on the topic of How to Avoid a Phoenix situation.

Transferring or Selling Assets – the three Principles

First principle - There is nothing illegal about the sale of company assets

There is no law or legal principle that says that a company in financial difficulty is prevented from selling assets. Indeed, it is a common occurrence and it is often the best way to maximise returns to stakeholders including creditors. However, having said that, there are a number of areas of the law that need to be considered and complied with. Whenever assets are to be sold to a related party the directors need to be particularly careful. Sections of the Corporations Law that need to be considered include the following:

- Section 588 FB(1) – Uncommercial Transaction – being a transaction that a reasonable person in the company's position would not have entered into considering any detriment to the company or a benefit to another party;
- Section 588FDA – Unreasonable Director Related transaction – being a payment or transfer of company property to a related party that was not reasonable;
- Section 180 and 181 – Care and Diligence and Failure to Act in Good Faith – being the “catch-all” sections to ensure directors act in the best interests of a company

Second principle - Any sale of assets needs to be at a "market value"

As a direct result of the Corporations Law section outlined above, where assets are to be sold to a related party, we always recommend that prior to the transaction, the directors obtain an external independent valuation of the assets to be transferred or sold.

In the case of the transfer of a whole business, it is usually acceptable for the company's external accountant to prepare either an Indicative Valuation or a full Valuation Report. In the case of the transfer of plant and equipment it is usually best to obtain a valuation from an Auctioneer – that valuation should provide both “Going Concern” and “Forced Sale” values. But which of those values to use? The answer will depend on the circumstances, but here are some examples:

- If the business is currently trading profitably and there are potentially a number of purchasers, then the sale price should be “Going Concern”;
- If the business is unprofitable and there are unlikely to be external potential purchasers then a sale price near “Forced Sale” can be appropriate (but you may want to query why the director wishes to buy and save such a business?)

Third principle - Whilst the sale of assets is being considered or completed, a director must be very careful not to incur any new liabilities.

If new liabilities are incurred during this process and they remain unpaid after the sale of assets then the directors may well be facing an Insolvent Trading action from a Liquidator, Creditors or ASIC. As a result, while the company is in the uncertain period of restructuring it is best not to incur new liabilities, or if liabilities are incurred, that they are paid. This can be best done by moving to pay suppliers on a C.O.D. basis.

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Use of Sale Proceeds

Where assets are sold it is important that the sale proceeds are dealt with in an open manner and for the sale proceeds to be easily traceable. It is best that following principles be applied:

- The sale proceeds are banked in full into the company's Bank Account;
- In a situation where creditors will not be paid in full, it is best to appoint a Liquidator immediately after the sale of assets so that the Liquidator deals with the proceeds of sale. A Liquidator can then ensure that creditors are paid in accordance with the Statutory Priorities as set out in the Corporations Law.
- A Director should avoid paying specific liabilities with the proceeds of sale. For example, Directors will sometimes seek to repay relatives, related parties, or creditors that hold a Personal Guarantee. In each of those situations a liquidator will have specific avenues of recovery and it is likely that all parties will be worse off due to unnecessary litigation.

Obtaining Specific Advice

We have outlined above some principles to adhere to in the sale or transfer of assets. However, each situation will be different.

Dissolve can provide specific advice on transactions being contemplated. However, be aware that if Dissolve provides specific advice on a transaction then we would be unable to subsequently act as a Liquidator or Voluntary Administrator.

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