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SALES OF BUSINESSES IN INTERNATIONAL CASES: CLEAR OR NOT-SO-CLEAR TITLE?

Sales of Businesses in Insolvency in Australia

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Corporate insolvency law in Australia is governed by the Corporations Act 2001 (Cth). There are two forms of external insolvent administration in Australia in which it is possible that a business will be sold as a going concern: voluntary administration and receivership.

First, if a company is put into voluntary administration (for example, by the directors appointing an administrator) and no secured creditor takes steps to appoint a receiver, the administrator may conduct a sale of the business of the company as a going concern. Secondly, a (secured) creditor, with a charge over all or substantially all of a company's assets, will ordinarily have rights under the instrument of charge to appoint a receiver with wide powers regarding those assets. These powers are supplemented by statutory powers of receivers in the Corporations Act with the result that such receivers will generally be empowered (among other things) to sell the business of the company as a going concern.

Sale of a business by an administrator

Administrators are required, within a statutory time limit referred to as the "convening period", to convene a (second) meeting of creditors for the purpose of the creditors determining whether the company should:

(a) execute a deed of company arrangement (which effectively amounts to a structured work-out, and which is known universally in Australia as a "DOCA");

(b) be taken out of administration; or

(c) be wound up (i.e. liquidated).

The convening period is short - 20 business days - and can only be extended by court order if the court is satisfied that it would be in the best interests of creditors to do so. Nonetheless, administrators are vested with broad powers as a result of their appointment, including the power to dispose of the business of the company or any of the company's property. If the administrator determines that the company is in a state of crisis which requires the immediate sale of its business, it is not necessary for the administrator to consult with creditors before completing the sale.

Duties of receivers and administrators while conducting the sale

If a decision is made by the receiver or administrator to sell the business of the company, his legal duties will dictate the processes he follows in marketing the business and conducting the sale.

Receivers have a duty to take "all reasonable care" to sell the property of a company for not less than the market value or, if the property does not have a market value, the best price that is reasonably obtainable in the circumstances. This is an important duty, and is designed to ensure that a receiver seeks the best price obtainable, and not merely a price that is sufficient to repay the debt owed to the secured creditor which appointed him.

In determining whether all reasonable care has been taken, a court will focus primarily on the sale process. This means, as a practical matter, that a receiver will almost always ensure that he takes the following steps:

(a) advertising sufficiently to bring the business to the attention of potential purchasers;

(b) testing the market by responding to enquiries and expressions of interest;

(c) obtaining, where appropriate, valuations or other expert advice; and

(d) conducting, where appropriate, a competitive tender or sale process.

Unlike receivers, administrators do not have a statutory duty to take all reasonable care to obtain the best possible price. However, an administrator does owe fiduciary obligations to the company and also has statutory duties of care, diligence and good faith equivalent to the duties and standards that apply to company directors. Thus, if the circumstances warrant, it is possible for an administrator to engage in a rapid sale process with a ready and willing buyer, without the market-testing process that a receiver will feel bound to follow. On the other hand, where an administrator considers that a market-testing process is appropriate, and in the best interests of the company, he ought follow such a process.

Marketing the business for sale

Administrators and receivers will generally place newspaper advertisements in national and local newspapers, and notices on websites, that a business is for sale. Advertisements may also be placed in international publications and relevant trade journals.

As a general rule, such advertisements will provide limited factual information and invite enquiries. Generally, a receiver or administrator will then prepare a more detailed information memorandum for distribution to parties he judges to be genuine potential purchasers. The scope and quality of this memorandum will depend on a number of factors, including whether there are still employees in the company with the knowledge and skill to assist in the preparation of the memorandum, the time available, and, inevitably, the funds available to the receiver or administrator to devote to the task.

In all circumstances, the receiver or administrator will be conscientious to include full and prominent disclaimers in the information memorandum. This is because Australia has wide ranging laws prohibiting misleading or deceptive conduct. Administrators and receivers are understandably very reluctant to make any representations that, due to their inadequate appreciation of the circumstances of the company they have recently assumed control of, might be characterised as misleading or deceptive.

Timing of the sale

As a general rule, the value of a company's business will be diminished the longer it is held by an administrator or receiver. Employees leave or are terminated because there are insufficient funds to pay them. Suppliers and creditors cease to deal with the company. Customers dry up. And insolvency practitioners do not come cheaply.

That said, it is sometimes the case that a receiver (or an administrator that has obtained a court order extending the "convening period") has funds to ensure the retention of key staff and to invest resources and skill in "dressing up" the business for sale. Where this is done well, the value of the business may even be enhanced. This is especially the case in circumstances where one of the key contributing factors to the company's financial difficulties is able to be identified and removed; for example, poor management.

Due diligence

Due diligence is critical to a prospective purchaser of a business in administration or receivership. This is because administrators and receivers will generally only sell a company's business on an "as is, where is" basis. Administrators and receivers are generally unwilling to give any warranties themselves, and any warranties given by a company that is insolvent are unlikely to be of great worth.

Despite this, the flow of information from a receiver or administrator to a prospective purchaser for due diligence will often be very poor because the key employees with ready access to the relevant information have left the business.

Particular issues of due diligence that a prospective purchaser will wish to satisfy themselves about are:

(a) Has the administrator or receiver been validly appointed?

(b) Is the administrator or receiver entitled to sell the assets?

(c) Retention of title claims by suppliers. Where the business has possession of chattels, or movable property, it may be necessary to investigate whether it holds those chattels subject to contracts containing retention of title clauses inserted by the suppliers. The effect of a properly drafted retention of title clause is that the (unpaid) person that sold the goods to the company has a superior claim to that of the company and, therefore, the administrator or receiver.

(d) Book debts. It is common practice in Australia that business book debts or receivables be excluded from the assets sold with the seller of the business appointing the buyer to collect receivables as its agent, and pass the proceeds to the seller.

(e) Books and records. As with the sale of any business as a going concern, the buyer will wish to take possession of the records of the business in order to enable it to continue to operate the business. A receiver or administrator will wish to have access to the records to enable him to continue his investigations and analysis into the affairs of the company and report to creditors (as well as complying with obligations to file statutory and tax returns).

Sale on an "as is, where is" basis

The first time that a buyer sees a business sale agreement prepared by a receiver or administrator, the differences from a "normal" sale agreement will be obvious. Administrators and receivers will offer no warranties, and will insist on strict exclusions of liabilities and indemnities in favour of themselves. The business is sold as it is, and where it is. And it is for the purchaser to work out what that means.

Warranties

An administrator or receiver is unlikely to offer a prospective buyer any warranties (or at best very few warranties) in relation to the business or the assets that are the subject of the sale. This means that in most cases the buyer will have to rely on its own investigations in relation to the past conduct of the business and in relation to the seller's title to (and the state of) any assets that are being sold.

In a "normal" business sale agreement, a buyer would at the very least expect to see warranties confirming that the seller holds good title to the assets and is entitled to transfer the assets to the buyer. A receiver/administrator is unlikely to be able to offer even this minimal comfort as there may be encumbrances and other securities in existence that they are not aware of, or title may be held by a separate entity without the administrator's/receiver's knowledge.

Any warranties that are provided will also be of little value to the buyer if they are only given by the insolvent (or potentially insolvent) company. Where a buyer is in a particularly strong bargaining position, it may insist that the administrator or receiver gives personal warranties in relation to the validity of his appointment and his actions during the period of appointment, however any personal warranties are likely to be strongly resisted by the administrator/receiver.

And even where warranties are given, a buyer will commonly find that the warranty period is short and other limitations are strict. This is important for the administrator/receiver so that he can determine a date following which any outstanding liability is at an end, and distribute any proceeds to creditors.

Exclusion of liability

Receivers and administrators are empowered to act as agent for the insolvent (or potentially insolvent) company. Notwithstanding that under general law an agent is not personally liable when acting on behalf of its principal, an administrator or receiver will be personally liable for certain debts incurred in the exercise of his powers as administrator or receiver during the course of the administration or receivership (as the case may be).

The terms of the sale agreement will generally make it clear that the buyer is contracting with the seller company in relation to the sale, and not with the administrator/receiver in his personal capacity. An administrator or receiver will usually seek to exclude all personal liability under the terms of any business sale agreement. This will prevent the buyer from making any claims against the administrator/receiver, and its only redress will be against the seller company (which is likely to be insolvent) as an unsecured creditor.

Indemnities in favour of administrators/receivers

Notwithstanding that he seeks to exclude his personal liability, an administrator or receiver will commonly also seek to take the personal benefit of any provision, indemnity, guarantee, exclusion, release, acknowledgement or waiver given in favour of the seller company. Any specific releases or indemnities in the business sale agreement will usually be drafted expressly to be in favour of both the seller company and the administrator or receiver in his personal capacity.

Limited value of obligations

As outlined, an administrator/receiver will seek to exclude any personal liability under a business sale agreement. As a result, where the buyer has a claim it will need to make the claim against the insolvent (or potentially insolvent) company as an unsecured creditor. In order to mitigate this risk, a buyer should place greater emphasis on the conditions precedent and completion conditions in order to ensure that it obtains good title to the assets and that the seller company discharges all of its critical obligations. If these obligations are not met, the buyer should ensure that it has the option to terminate the business sale agreement and walk away from the transaction.

If these obligations are not able to be discharged by the seller company prior to completion of the sale, and the buyer still wishes to proceed, the buyer may elect to:

(a) insist that the administrator/receiver provides a personal "procuring" obligation to ensure that the obligation is later discharged; or

(b) create a retention regime, whereby the purchase price (or other deliverables) is only released when the obligations have been performed.