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Company Insolvency and the Liquidation Process

Frequently Asked Questions

The Answers to the FAQs by Andrew Oorschot
Our Insolvency Partner at Ashton Wheelans

We can provide general insolvency advice to you as a director, shareholder, employee, security holder, creditor or other party with regards to your rights, obligations and options pre and post an insolvent position occurring within a company or of an individual.

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Table of Contents

What is Company Insolvency? 3
What is Company Liability -v- Personal Liability? 3
What is a Personal Guarantee? 3
What are my Pre and Post Insolvency Options? 3
What is a Creditor Compromise? 3
What is the new Business Debt Hibernation regime? 4
What is Receivership? 4
What is Voluntary Administration? 4
What is Liquidation? 5
What are the different types of Liquidation? 5
1. Shareholder resolution for Voluntary Liquidation 5
2. Court Order for Liquidation 5
3. Creditors pass resolution for Liquidation at Watershed meeting 5
Liquidating an insolvent company- what is involved? 6
What can I expect during the administration of the Liquidation? 6
The Liquidation Process simplified 7
How much will a Liquidation Cost? 7
What are the effects of a Liquidation? 7
Effects on Directors 7
Effects on Employees 8
Effects on Creditors 8
What are my duties as a Director and what is reckless trading? 8
The Companies Act 1993 8
Reckless Trading and Duty in Relation to Obligations 9
What Insolvency Relief ie. Safe Harbour has the Government introduced? 9

What is Company Insolvency?

For a company to be insolvent means either one of two things:

- Debts can't be paid when they're due (the cashflow test) or,
- Total debts are more than the value of all assets (the balance sheet test).

What is Company Liability -v- Personal Liability?

A company is a legal entity. There is a legal protection available to company owners or shareholders when operating a business through a company called limited liability.

A busines which is trading as a company can (generally) enjoy this limited liability and does not risk his or her personal assets and possessions if the business fails and there are business debts.

Of course, there are some instances whereby personal liability as a director of officer of the company may arise if he/she:

a) Personally and directly injures someone;

b) Personally guarantees a bank loan or other business debt and the company defaults;

c) Fails to deposit taxes withheld from employees' wages;

d) Intentionally engages in fraud or illegality which causes harm to the company or someone else;

e) Mixes business and personal assets and does not maintain separate accounts for the business and personal finances.

What is a Personal Guarantee?

A guarantor is someone who agrees to repay the debt of a company or person if they default. Company directors often guarantee their company's debts, which means they have to repay them if the company goes into liquidation.

What are my Pre and Post Insolvency Options?

There are varying options available to a business if insolvency is looming.

What is a Creditor Compromise?

As an alternative to liquidation, the directors (or a creditor, liquidator, receiver or shareholder), can propose a creditors compromise to repay a percentage of the debts the business owes over an agreed timeframe, so it can continue operating, to achieve a better outcome than a liquidation of the company.

A compromise is a means by which an indebted company may reach an arrangement with its creditors to pay them less than the full amount owing or to pay the amount owing over

an extended period of time in full and final settlement of the debts covered by the compromise proposal.
The compromise document is usually prepared by an accountant and is issued to creditors to consider and vote on at a formal meeting of creditors. The creditors meeting can be held by way of a physical meeting or postal vote. The compromise will take effect if it is approved by creditors holding at least 75% of the monetary value of the company's debt. The compromise is binding on all creditors and prevents any one of them from applying to the High Court for the company to be liquidated.

What is the new Business Debt Hibernation regime?

The Business Debt Hibernation regime is a new temporary measure being brought in by the Government to assist companies who have difficulties paying their creditors because of the Covid-19 pandemic.

The company may reach an arrangement with its creditors to repay debts the business owes. The level of creditor approval is less, being 50% in number and value (as opposed to 50% in number and 75% in value for an administration or compromise). Creditors will have a month from the date of notification of the proposal to vote on it. There will be a one month moratorium or breathing space on the enforcement of debts from the date the proposal is notified, and a further six month moratorium if the proposal is passed.

Directors can commence the process which is designed to be quick and flexible. A standard form is expected to come from the Companies office.

Creditors who continue to trade with the company will be protected from voidable preference claims during this process if the company subsequently goes into liquidation (so long as they are not a related party, have acted in good faith and without intent to deny other creditors).

Legislation is to be released shortly and will be backdated to the start of the lockdown period.

What is Receivership?

A receiver is appointed by a secured creditor to deal with the secured assets. A company can be in receivership and also in liquidation or voluntary administration.

The receiver, once appointed, may elect to trade in receivership or shut the business down depending on the state of the business and what is in the best interest of the creditors.

The receiver has secondary duties to unsecured creditors, guarantors and shareholders to take reasonable care with the assets of the receivership, particularly on realisation of those assets. The receiver owes a specific duty when selling the company's property to "obtain the best price reasonably obtainable at the time of sale".

A receiver must resign once the appointing secured creditor has been repaid.

What is Voluntary Administration?

An administrator is appointed to review and rearrange a business to avoid liquidation. The administrator can be appointed by the directors of the company, a liquidator, a secured creditor or the court.
The administrator has 8 working days to call the first creditors' meeting for the directors to table an initial statement concerning the affairs of the company and financial position. A second meeting then must be called within 20 days of the appointment of the administrator. At this meeting the administrator may put forward a "deed of company arrangement" which must be approved by 50% in number and 75% in value of creditors at the second meeting (Watershed Meeting).

If the deed is executed, the Directors regain control of the company with powers depending on terms of deed.

If deed is terminated, the Directors regain control of the company unless the deed provides for the company to go into liquidation.

If creditors resolve that the administration should end, the Directors regain control of the company and are responsible for ensuring that the company pays its outstanding debts as they fall due.

What is Liquidation?

The process of closing down and removing a company from the Companies Register. A Liquidator is appointed to investigate and deal with all the business assets.
Liquidation is discussed under the following headings:

What are the different types of Liquidation?

Solvent Liquidation – Company has ability to pay their debts and surplus will be distributed to Shareholders.

Insolvent Liquidation – There are insufficient monies to pay the Company's debts
There are three systems of placing a company into liquidation.

1. Shareholder resolution for Voluntary Liquidation

Determine the company is unable to pay its debts.
Liquidators can be appointed for both Solvent and Insolvent company liquidations. The shareholders agree to appoint a liquidator by way of a special resolution document.

2. Court Order for Liquidation

This follows a successful application by a creditor to the Court to appoint a liquidator.

If an application to liquidate has been served on a company the shareholders have only 10 working days in which they can pass a special resolution to appoint a Liquidator otherwise the application must be dealt with by the Court.

3. Creditors pass resolution for Liquidation at Watershed meeting

At the Watershed meeting during a voluntary administration regime, the administrator will put forward a "deed of company arrangement".

The deed of company arrangement may be terminated and provide for the administration of the company to end and the company to be placed into liquidation.

Liquidation of an insolvent company- what is involved?

Formally winding up/closing down a company involves:

- Appointing a Liquidator by a special resolution approved by 75% majority of Shareholders.
- The Liquidator notifies the Companies Office and advertises the appointment.
- A creditors Meeting may be held- should creditors decide to have a creditors meeting, they can vote on whether a replacement liquidator should be appointed.
- Administration of the Liquidation, including realisation of assets, dealing with creditors' claims, reviewing events leading up to liquidation (eg potential voidable/insolvent liquidations, directors conduct etc)
- Completion - The final report is sent to creditors and the Companies Office is notified. Should no objections be received, the company is then removed from the Companies Office Register after 20 working days.

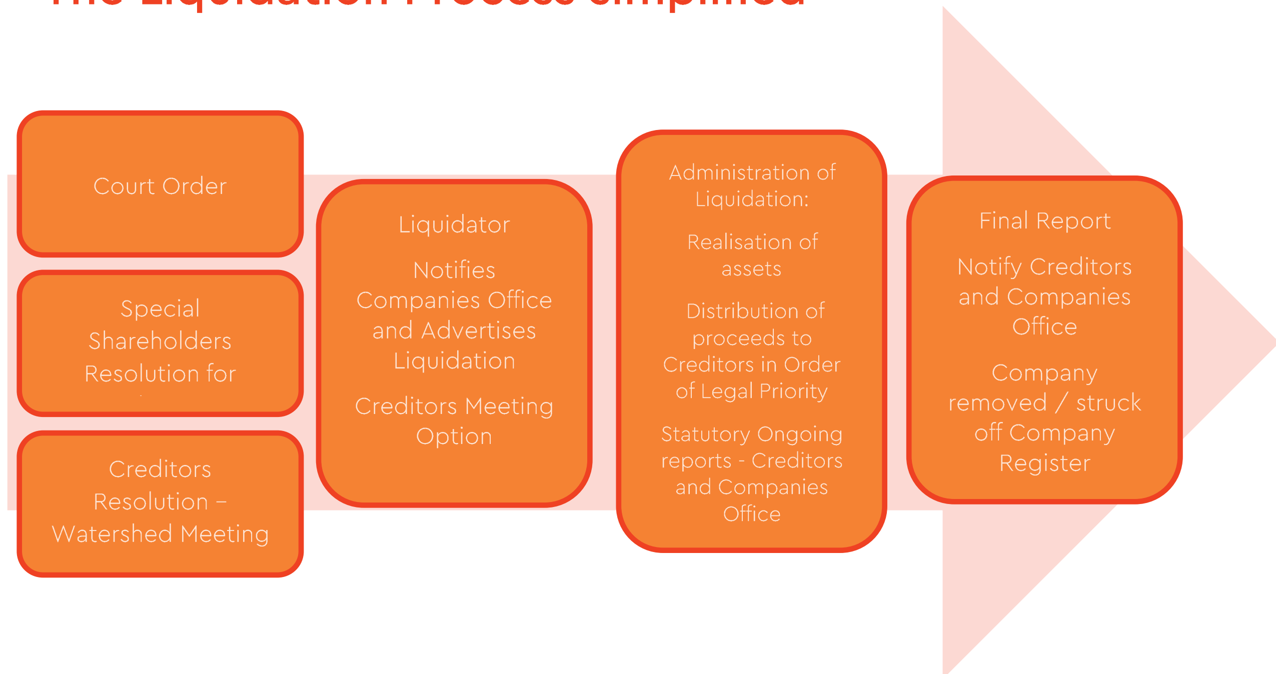
What to expect during the administration of the Liquidation

The liquidation will generally include:

- Ceasing trading/ closing the business and vacating the premises
- Securing any physical assets available for realisation and/or intangible assets ie fixed assets and collecting the debtor amounts due to the company. The Liquidator takes custody and control of the company assets.
- Liquidator will talk with you about your creditor debt. The Liquidator deals with all creditor enquiries and claims including updating the IRD.
- Liquidator will realise all company assets and distribute funds (if any) to creditors in order of legal priority.
- Liquidator will review company financial records to investigate possible offences or unusual transactions

- Sending an Initial Liquidators Report and Progress Reports to creditors and upload to Companies Office

The Liquidation Process simplified



How much will a Liquidation Cost?

The cost of Liquidation varies according to the size and complexity of company and the type of Liquidation procedure.

Company Liquidation costs, and who pays will be a key part of deciding whether Liquidation is the right option for your company.

- If the company has assets that can be sold, the Liquidator's fee will be charged as a cost of the liquidation – payable out of the proceeds realised as a preferential creditor.
- Should the company have no assets, the Liquidator may ask for a contribution in advance from the shareholders for the initial Liquidation costs/disbursements.

What are the effects of a Liquidation?

Effects on Directors

- Cooperate with the Liquidator so that the financial and business affairs of your company can be resolved fairly and equitably,
- Provide your company's accounts, records and any other information the Liquidator requires;
- The Liquidator will also check whether the directors or shareholders owe any money to the company, and whether any offences have been committed; and

- Once a company goes into Liquidation, the director is no longer required to file tax returns on behalf of the company (that fall due after the date liquidation only).

Effects on Employees

The liquidator will decide if the business should continue trading so it can be sold as a going concern. If the business is closed all employment contracts will be terminated.

- Employees can file a claim in the liquidation if owed any salary, wages, holiday pay or redundancy. A claim may be considered preferential, which means it will be paid out before the unsecured creditors if there are funds available.

Effects on Creditors

Secured creditors can seize and deal with the company's secured assets themselves or can choose to allow the Liquidator to realise the assets and account to them for the proceeds net of selling costs. Alternatively, a secured creditor holding a general security over all present and after acquired property of the company may decide to appoint their own Receiver to deal with the secured assets. They can claim as an unsecured creditor for any shortfall.

The Companies Act 1993 sets out the priority of payments where there are funds to distribute to creditors in a liquidation in the following order:

1. Liquidator fees, expenses and costs incurred during the liquidation;
2. Costs awarded by the court to the applicant creditor;
3. Costs and claims of a creditor who has assisted with the recovery of assets;
4. Actual 'out-of-pocket' expenses of any liquidation committee;
5. Wages owed to employees for the four months prior to the liquidation and all holiday pay and redundancy payments up to a specified statutory maximum amount;
6. Preferential taxes collected for Inland Revenue (eg GST, PAYE, RWT);
7. All other unsecured creditors (who rank equally).

Unsecured creditors can't take or continue legal action against a company in liquidation or deal with its property unless they have permission from the Court or the Liquidator.

What are my duties as a Director and what is reckless trading?

The Companies Act 1993

The Companies Act provides the framework that applies in respect of directors' duties and reckless trading as follows:

Section 131: Duty of directors to act in good faith and in best interests of the company

Section 133: A director must exercise a power for a proper purpose

Section 134: Directors to comply with Act and constitution

Section 135: Reckless Trading

Section 136: Duty in relation to obligations

Section 137: Director's duty of care

Criminal Offences:

Section 138A: Offence for serious breach of director's duty to act in good faith and in best interest of the company

Section 380: Carrying on business fraudulently or dishonestly incurring debt

Reckless Trading and Duty in Relation to Obligations

The Companies Act 1993 prohibits a director from allowing the business to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. Any director who fails to exercise necessary care or prudence and/or takes illegitimate business risks may be found personally liable for reckless trading and can be held personally liable for some or all the company's post liquidation losses to creditors.

In addition, to section 135, section 136 provides that "a director must not agree to the company incurring an obligation unless the director believes at that time on reasonable grounds that the company will be able to perform the obligation when it is required to do so".

What Insolvency Relief ie. Safe Harbour has the Government introduced?

The government has announced a temporary "safe harbour" in respect of breaches sections 135 and 136 of the Act given the effect of Covid-19 on businesses and the difficulties faced by directors in complying with their duties. This removes their potential personal liability for breach of these duties.

For the next six months, directors who continue to trade their companies, which includes taking on new obligations, will have a "safe harbour" from potential claims under sections 135 and 136 the Act provided that:

- In their opinion, acting in good faith, the company is likely to face significant liquidity problems in the next six months as a result of Covid-19;
- The company was able to pay its debts as they fell due at 31 December 2019; and
- In their opinion, acting in good faith, it is more likely than not that the company will be able to pay its debts as they fall due within 18 months. This may be as a result of improved trading conditions or their genuine belief that they will be able to reach an accommodation with their creditors.

Directors should seek advice to assist them in determining whether safe harbour applies.

Legislation is to be released shortly and will be backdated to the start of the lockdown period.

If you have any other questions feel free to email us at: liquidations@ashtonwheelans.co.nz