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INSOLVENCY

Nobody ever starts a business expecting it to fail. Owners of start-up businesses and purchasers of existing businesses typically believe that their business will flourish and succeed. However, factors such as a product offering that consumers do not want, external circumstances (e.g. market downturn) and/or business owners lacking the required skillset needed to operate a successful business, can result in the failure of some businesses.

We have outlined below factors to consider from a legal perspective to help prevent insolvency and outline processes that need to be followed if your business is failing. In this article we have focused on company insolvency since most businesses in New Zealand are operated by companies.

Company insolvency

If a company is not in a position to pay its debts as they fall due, the company may be liquidated, placed into receivership or enter voluntary administration.

Company liquidations can be voluntary or involuntary.

A voluntary liquidation typically commences upon the shareholders of the company passing a special resolution to liquidate the company. An involuntary liquidation generally occurs where a liquidator is appointed by the High Court or following a resolution passed at a watershed meeting of creditors. A liquidation essentially means the company is at an end.

A secured creditor, typically the company's bank, may appoint a receiver if the company has failed to pay the secured creditor. The receiver may sell secured assets and manage preferential claims (e.g. unpaid wages and amounts owing to the IRD) before secured creditors are paid. Receiverships do not always signal the end of a company's life. In some cases, it is possible for the secured creditor to be repaid in full during a receivership, with the company able to carry on trading.

Voluntary administration can allow directors to re-organise and re-finance the business in the hope that it can continue to trade or allow a plan to be developed to dispose of the business assets so that creditors and shareholders may receive a better result than an immediate liquidation.

If your business is struggling, we recommend you get accounting and legal advice as to which of these options may be most appropriate.

Statutory demands

If your company fails to pay a debt of at least $1,000 on time, and the debt is not disputed, the creditor may serve a statutory demand on your company. The statutory demand will state that your company must pay the amount owing or otherwise reach a compromise with the creditor within 15 working days of service of the statutory demand. If the debt is genuinely disputed you must apply to the High Court to have the statutory demand set aside within 10 working days of being served. You must take statutory demands seriously because if you have not acted before that timeframe has expired, your company will be presumed insolvent and the creditor can apply to the High Court to have a liquidator appointed.

Liquidation process

The liquidator's primary role includes:

- Distributing the company assets or their sale proceeds to the company's creditors, and then to the shareholders if there is a surplus;
- Reporting to creditors and shareholders;
- Investigating whether the company's directors have complied with their director duties; and
- Investigating whether creditors have received preferential treatment in the period leading up to the liquidation to the detriment of other creditors.

The Companies Act 1993 requires the liquidator to make payments from funds held by the liquidator after selling the company's assets, in the following order of priority:

Liquidator's fees and expenses;

- Costs awarded by the court to the creditor that applied to liquidate the company;
- Costs and claims of a creditor who assisted in recovering assets;
- Expenses of any liquidation committee;
- Wages owed to employees for the four month period prior to liquidation and all holiday pay and redundancy payments up to a specified maximum amount;
- Payments to secured creditors;
- Preferential taxes collected for the IRD;
- Payments to other unsecured creditors; and
- Any remaining funds (if any) are paid to the shareholders.

While a company is in liquidation the directors must co-operate with the liquidator, but otherwise their powers as a director are very limited.

Upon completion of the liquidation process, the Companies Office will be notified and the company will be removed from the companies register.

Potential director liability

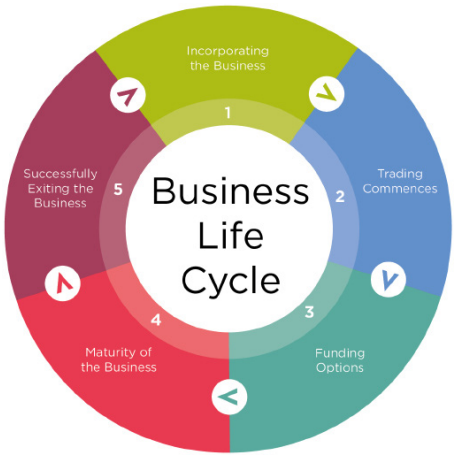
We have discussed directors' obligations to comply with their duties under the Companies Act in a previous article in this series (https://www.wynnwilliams.co.nz/Business-Life-Cycle/Business-Life-Cycle-Toolkit-Article-9-Director-Dut.aspx). As noted above, during the liquidation process liquidators will consider whether directors may have breached their duties. If the liquidator thinks this is likely, the liquidator may initiate court proceedings against the directors.

If a court finds that a director has breached their duties, the court may impose a fine or potentially sentence the director to a term of imprisonment.

Often directors, during the course of the business's operations, will have personally guaranteed the payments of the company to its suppliers, landlord, banker etc. If the company becomes insolvent, these creditors may call on these personal guarantees and seek payment from the directors personally.

If a director does not have the means to pay any fines imposed for breach of directors' duties or pay company debts where a personal guarantee is enforced, the liquidator or creditors may take steps to commence bankruptcy proceedings against that director.

For these reasons, it is important that directors take care to protect their personal assets (such as through a trust) and carefully consider the implications before entering into personal guarantees.



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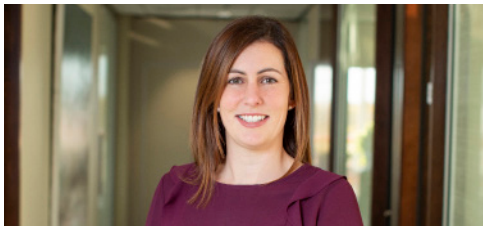

Phoebe Davies
Partner

P: +64 3 353 0221
M: +64 27 414 9825
E: phoebe.davies@wynnwilliams.co.nz

Phoebe advises on a wide range of corporate and commercial law, including overseas investments, mergers and acquisitions, corporate structuring, shareholders' agreements, corporate governance and commercial contracts.

Phoebe acts for clients in a broad range of industry sectors with specialist knowledge in the agribusiness and consumer finance sectors.

In addition to Phoebe's New Zealand experience, she has worked for international firms in both London and Birmingham in the United Kingdom, and is qualified to practice law in both New Zealand and England & Wales.

Charlene Sell
Partner

P: +64 3 379 7622
M: +64 27 685 5653
E: charlene.sell@wynnwilliams.co.nz

Charlene advises business owners and managers on how to structure their businesses and how to resolve their day-to-day issues. Her expertise includes business acquisitions and sales, drafting and providing advice on commercial contracts and terms of trade, advising on export arrangements, dealing with employment matters and protecting clients' brands.

Charlene also advises business owners with structuring their personal affairs, including establishing family trusts and advising on succession planning.

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