Norrie & Daughters

Accounting Services | Taxation Services | Liquidations | Trusts

A GUIDE TO COMPANY

INSOLVENCY & LIQUIDATION

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Introduction

Thank you for downloading this guide. This guide is intended to provide a more detailed overview of the process of liquidation, the role of the liquidator and how it affects, creditors, directors and shareholders of a company in liquidation. A small part is devoted to statutory demands and what to do if your company has been served with a statutory demand. It is stressed that this booklet is not a replacement for proper legal and/or accounting advice and you should contact your solicitor for legal advice or your accountant for accounting advice. This booklet is merely a more detailed but high level overview than a small brochure you may find on the table at your solicitor or accountants office. To the best of our abilities we have tried to ensure that this booklet is current at the time of publishing. We trust you find it useful whether you are interested as a company director, creditor or if you are looking to appoint a liquidator to a company.

This guide may include certain processes that Norrie & Daughters use therefore if you choose another liquidator then some of the information provided in this guide may not apply.

Whilst we strive to keep this guide reasonably up to date legislative and other changes may cause some parts of this guide to become out of date. Unless stated otherwise all references to the Companies Act mean the Companies Act 1993 and Regulations means The Companies Act 1993 Liquidation Regulations 1994. Norrie & Daughters staff trust you will find some benefit in this booklet.

Definitions

Meaning of "Board"

Generally, the "board" will be a quorum of directors acting together as the board of directors. However, in accordance with the Companies Act's recognition of a one-person company, the board can constitute a sole director

Meaning of "director"

Directors can come in more than one form under the Companies Act.

A De jure" director(s) — those actually appointed director is a person occupying the position of director of the company by whatever name called"

A de facto director, although not actually appointed, is one who is held out by the company, and purports to act, as a director.

Other types of directors are:

(a) A "shadow director";

(b) A person with managerial powers under the company constitution;

(c) A de facto director;

(d) A delegate of the board;

(e) The controller of any of the above (the labels "ultimate controller" and "master director" are also used to describe a person acting in this way); and

(f) A shareholder.

Whilst it may usually seem obvious what and who a director is examples of de-facto directors would include bankrupts being a director, an alternate director or a shareholder who directs the board.

Meaning of "Shareholder"

Shareholders are the "proprietors" of the company, but they do not own the company's property. They provide capital for use by the company in its undertakings. Generally, shareholders are entitled to an equal share of any dividend declared by the company and an equal share of the surplus assets of the company (if any) at the time of liquidation, following satisfaction of all preferential claims and payment of the company's creditors.

Meaning of "Solvency Test"

The Companies Act sets out the solvency test, which comprises two limbs, the liquidity limb and the balance sheet limb. The solvency test plays an important role in the management of companies. Both limbs must be met in order for the company to be found solvent.

Liquidity limb means: That to satisfy this test the company must be able to pay its debts as they become due in the normal course of business.

Balance sheet limb means: That to satisfy this test, the value of a company's assets must be greater than the value of its liabilities, including contingent liabilities. It is mandatory under s 4(2) if the Companies Act to have regard to the most recent financial statements of the company, and to all other circumstances that affect or might affect these values.

A contingent liability may include guarantees, uncalled share capital, letters of credit, bills of exchange, pending litigation, lease obligations, performance bonds, underwriting, or hire purchase agreements

The solvency test does not require a company to be solvent on every day the company trades, but applies when certain transactions are proposed. The solvency test applies to:

(a) The making of distributions under Part 6 (including dividends, financial assistance, buy-backs, and share redemptions);
(b) A discounts scheme approved;
(c) The powers that all entitled persons may approve under s 107(1);
(d) Buy-out rights under;
(e) Amalgamations under Part 13; and
(f) Transfer of registration under Part 19.

In many cases, as a result of prudent management, companies will meet the test fairly easily. Moreover, directors will be aware from their general knowledge of the company's affairs that this is the case. However, directors of companies that are marginally solvent will need to know with certainty whether the test has been satisfied, as this may be difficult to establish at a later stage.

Meaning of "inability to pay debts"

Unless the contrary is proved, and subject to section 288 of this Act, a company is presumed to be unable to pay its debts if—

(a) The company has failed to comply with a statutory demand; or
(b) Execution issued against the company in respect of a judgment debt has been returned unsatisfied in whole or in part; or
(c) A person entitled to a charge over all or substantially all of the property of the company has appointed a receiver under the instrument creating the charge; or
(d) A compromise between a company and its creditors has been put to a vote in accordance with Part 14 of the Companies Act but has not been approved.

Statutory Demand

A statutory demand is a demand by a creditor in respect of a debt owing by a company made in accordance with section 289 of the Companies Act.

(2) A statutory demand must—
  (a) Be in respect of a debt that is due and is not less than the prescribed amount; and
  (b) Be in writing; and
  (c) Be served on the company; and
  (d) Require the company to pay the debt, or enter into a compromise under Part 14 of the Companies Act, or otherwise compound with the creditor, or give a charge over its property to secure payment of the debt, to the reasonable satisfaction of the creditor, within 15 working days of the date of service, or such longer period as the Court may order.

It is not necessary for a judgment to be obtained before the service of a statutory demand. The debt must however be due and presently payable as at the date on which the statutory demand is served.

Statutory demands should be used to prove insolvency of a company rather than as a means to collect outstanding money.

If a statutory demand has been served on your company then you have a number of options:

(a) Pay the debt

(b) Enter into a compromise with the creditor under Part 14 of the Act which means under the compromise it may be possible to

I. Cancel all or part of a debt of the company;

II. Vary the rights of the company's creditors or the terms of the debt;

III. An alteration of a company's constitution that affects the likelihood of the company being able to pay a debt.

"Compounding" is a word used in statutory demands which appears to refer to a similar process whereby the creditor and the debtor reach mutual agreement to the reasonable satisfaction of the creditor as to the payment of a debt:

(c) Apply to the High Court to have the statutory demand set aside.

If your company is unable to do or achieve any of the above then we strongly recommend that the board and shareholders consider appointing a liquidator. Failure to pay or settle a statutory demand is proof of insolvency which means the company has failed the solvency test. Directors who trade a company whilst insolvent can be held liable for certain debts of the company, creditors and shareholders. Any conduct that is contrary to the rules of company law and which causes loss to the company, creditors and others is actionable against a director.

Directors should immediately obtain legal advice if their company is served with a statutory demand.

Court Initiated Liquidation

If a statutory demand is not settled then it is likely the entity that served the statutory demand will apply to the High Court for the debtor company to be put into liquidation.

One of the grounds on which a Court may appoint a liquidator (and consequently put a company into liquidation) is when it is satisfied that the company is unable to pay its debts and the failure to settle a statutory demand creates an automatic presumption that a company is unable to pay its debts. In the absence of evidence before the Court that is sufficient to rebut that presumption, the Court will normally order the appointment of a liquidator.

The Court can even go as far as proceeding to appoint a liquidator even if the amount demanded in the statutory demand has since been paid. This is probably most particularly relevant when the statutory demand has been issued by Inland Revenue and where further penalties and interest have accrued between service of the statutory demand and payment of the statutory demand but these further accruals have not been paid.

The best option if a company has been served Notice of an Application for Appointment of a Liquidator is to appoint have the shareholders or board appoint a liquidator. Such an appointment can only be made within 10 working days after service of the application on the company

Shareholder Appointed Liquidator

All necessary resolutions and minutes will be prepared by Norrie & Daughters.

The most common method is shareholders appointing a liquidator by a special resolution of those shareholders entitled to vote. This would probably occur after the directors of the company have advised the shareholders that this is the prudent course of action.
A liquidator may be appointed by a special resolution of shareholders entitled to vote and voting on the question. A shareholder is a person whose name is entered in the company's share register as the holder for the time being of one or more of the company shares and a special resolution means a resolution approved by a 75 percent majority of those shareholders entitled to vote and voting on the question, unless a greater majority to pass a special resolution is required by the company's constitution.
A special resolution may be passed at a company properly constituted shareholders' meeting or a special resolution may also be passed without a meeting if a resolution in writing is signed by not less than 75 percent of the shareholders who would be entitled to vote on the resolution at a shareholders' meeting and who hold not less than 75 percent of the votes entitled to be cast on that resolution.
Once a company is put into liquidation by way of special resolution that special resolution cannot be rescinded

Board Appointed Liquidator

The board of a company may also appoint a liquidator but only upon the occurrence of an event specified in the company constitution.
Most companies are unlikely to have constitutions which provide for their liquidation on the occurrence of specified events therefore it is very important that if the board considers that a liquidator should be appointed a shareholders meeting is called or shareholders are adequately briefed.
If the company's constitution does not allow the board to appoint a liquidator then a liquidator would be appointed by way of special shareholders resolution.

Key Point on Shareholder/Board Appointment

There are limitations on when shareholders or the board of a company can appoint a liquidator. The right of shareholders or the board to appoint a liquidator is available at any time up to within 10 working days after service of an application on the company to appoint a liquidator. The creditor who filed the application to appoint a liquidator may subsequently apply to the Court for a review of the appointment.
A resolution of shareholders appointing a liquidator is not effective if, at the time of its passing, the proposed liquidator has not provided written consent to such appointment

Alternatives to Liquidation

Workouts

This is an informal process outside of the statutory regime. If a problem is identified and acknowledged early enough then this may be a viable option.

Fundamentally this a creditor compromise without all of the costs, publicity and complexities that a formal creditor compromise can entail. Essentially the company's creditors agree by contract to defer, compound or compromise their debts, with or without additional injections of working capital or other supporting mechanisms; (for instance debt for equity swaps).
The advantages of a workout are flexibility, more control and less expense and complexity but they still require the agreement of all of the company's creditors however depending on the state of solvency and type of creditors a work out in some circumstances may be achieved by working with a limited number of key creditors.

Creditor Compromises

A creditor compromise can be a practical and cost effective way forward. A compromise implies some accommodation on each side that results in agreement between a company and its creditors which will presumably be regarded as beneficial by all parties entering into the agreement.
Because a compromise is approved by creditors or by a class of creditors, it will be binding on the company and therefore, it is possible for creditors to impose a compromise on the company not only in relation to its debts.
Key Points of a Creditor Compromise Include:

- The directors of a company can propose a creditors compromise.
- The current directors and key staff may remain in control of the company.
- The proposal requires careful drafting to ensure its effectiveness over the life of the compromise.
- Protection from unsecured creditors can be granted by the courts.
- A receiver or liquidator can be appointed.
- A compromise, including any amendment, approved by creditors or a class of creditors of a company in accordance with the Companies Act is binding on the company and on all creditors all class of creditors.

Voluntary Administration

A company may appoint an administrator if the board of the company has resolved that,—

(a) in the opinion of the directors voting for the resolution, the company is insolvent or may become insolvent; and

(b) an administrator of the company should be appointed.

The company's board may appoint an administrator so long as the board has passed a resolution that complies with the requirements of the Companies Act. However, the company must not appoint an administrator if a liquidator has already been appointed or if more than 10 working days has passed following service on the company of an application to Court to appoint a liquidator
Key Points of a Creditor Compromise Include:

a) The powers conferred on the administrator by the Companies Act only continue while the company is in administration. This period will not generally continue beyond 25 working days after the appointment, unless the Court agrees to an extension. This is when the watershed meeting of creditors is to be held and at which a decision is made on whether:
   i. a deed of company arrangement is to be executed by the company in which case the powers of the deed administrator are governed by the terms of the deed.
   ii. resolve to terminate the administration or to appoint a liquidator.

b) The administrator's powers must be exercised in the interests of the company's creditors and shareholders.

c) While the appointment of an administrator does not remove the directors from office, none of the directors may exercise any of their powers as directors without the administrator's prior written approval or as otherwise authorised.

d) Probably in exercising the company's powers, the administrator will be subject to similar duties to which liquidators are subject in the performance of their functions.

What is a Watershed Meeting

A watershed meeting is a meeting of creditors called by the company Administrator at which the creditors vote on the options outlined above.

What is Liquidation

Liquidation is the method by which a company's (which is a legal entity separate from its shareholders and directors) existence is bought to an end. Liquidation occurs on the appointment of a liquidator.

Why are Liquidators Appointed

There are a number of reasons why companies are put into liquidation. They are:

- The inability of the company to pay its debts. (The most common reason)
- The company is solvent and ceased trading and the shareholders want to liquidate the company for a variety of reasons.
- An event has occurred that is set out in the constitution of the company that requires the board to appoint a liquidator.
- Creditors have appointed a liquidator at a watershed meeting.
- The Court has appointed a liquidator.

All liquidations, whether solvent or insolvent, voluntary or not, are commenced by the appointment of a liquidator although the steps leading up to the appointment may be different. It is important to note that although the process of appointment may be different the subsequent procedures are essentially the same.

Solvent v Insolvent Liquidations

A company can be put into liquidation by special resolution of the shareholders, whether or not that company is able to pay its debts. The liquidation procedure is basically the same whether the company is solvent or insolvent. However, in the case of the liquidation of a solvent company, no creditors' meetings need to be called if the board has resolved within 20 working days before the liquidator's appointment that the company would be able to pay its debts on that appointment taking effect.

It must be borne in mind that what start out as solvent liquidations can end in being an insolvent liquidation.

Liquidation v Non Liquidated Company Struck Off Register

There are clear benefits in completing a solvent liquidation as opposed to just allowing a company to be struck off the register.

A number of classes of persons or entities may apply to the High Court to have a company reinstated, they include:

(a) Any person who, at the time the company was removed from the New Zealand register,—
  (i) Was a shareholder or director of the company; or
  (ii) Was a creditor of the company; or
  (iii) Was a party to any legal proceedings against the company; or
  (iv) Had an undischarged claim against the company; or
  (v) Was the liquidator, or a receiver of the property of, the company:

(b) The Registrar:

(c) With the leave of the Court, any other person.

In a liquidation the actions of the liquidator, inactions of other parties or the process of liquidation brings a level of certainty to the cessation of the company and any future liability of the company and its directors and shareholders. Practically provided the liquidator has carried out his job correctly and no fraud by directors or shareholders has occurred then from the above list of persons no one is likely to seek reinstatement, creditors because all assets have been realised and distributed, shareholders because they either voted for liquidation or the court appointed a liquidator and any legal claimant would have no chance of receiving satisfaction of a judgment. This is not the case when a company is just left to be removed from the register. The courts have the power to appoint a liquidator to company that has been removed from the register.

Interim Liquidator

An interim liquidator is appointed only in exceptional circumstances.

The method of appointment is through the Court appointing an interim liquidator upon hearing an ex-parte application.

The Court's discretion to appoint an interim liquidator is that such an appointment will only be made if the Court can be satisfied that it is necessary or expedient for the purpose of maintaining the value of the assets owned or managed by the company.

The powers of an interim liquidator are much less than a liquidators powers and are generally limited to maintaining the value of the company's assets and any other orders the Court makes.

Insolvency is not a reason for appointment of an interim liquidator and the following considerations must be taken into account:

(a) Whether the company's assets are in jeopardy;

(b) Whether the status quo should be maintained; and

(c) Whether the interests of creditors are safeguarded.

If you think that you wish to have an interim liquidator appointed to a company you may contact us but a law firm experienced interim liquidator applications will also need to be involved. Clearly you need to consider the costs versus benefits of such an application.

What Happens When a Liquidator is Appointed

The principle duty of a liquidator is set out in the Companies Act 1993. They are:

(a) to take possession of, protect, realise, and distribute the assets, or the proceeds of the realisation of the assets, of the company to its creditors in accordance with this Act; and

(b) if there are surplus assets remaining, to distribute them, or the proceeds of the realisation of the surplus assets, in accordance with section 313(4)—

in a reasonable and efficient manner.

The liquidator achieves the above by:

From the date of liquidation the liquidator takes control and custody of the company's assets in order to protect, realise and distribute the proceeds of realisation of those assets to the creditors and possibly the shareholders. As part of realising the assets of the company, debtors and voidable transactions or incorrectly preferred creditors may be pursued. Shareholders who owe the company money must pay the money to the company.

The directors remain in office but cease to have powers, functions, or duties other than those required or permitted to be exercised by Part 16 of the Companies Act.

What we do Upon Appointment – Non Trading Company

Upon appointment of Norrie & Daughters staff as liquidators we will as soon as possible:

Advise of our appointment to the Companies Office, the company's bank, known creditors, accountant and solicitor. A public notice will also be published.

Meet with the director(s) and interview them to obtain reports from directors as to:

- Assets: location, what type of asset, insurances, registered security(s) over the assets.
- Liabilities: what liabilities are owed and to whom.
- Records: location of all company records.
- Professional Advisers: - accountants, solicitor, business consultant etc.
- Business History: business trading and why it went into liquidation.

We will immediately secure all assets that we can locate. Directors have a responsibility to ensure that the liquidator is advised of all known assets and their location.

Review what records and information we have obtained from the directors and others.

Prepare an initial statement of affairs based upon what records and information we have obtained from various sources and publish our first report setting out our understanding of the affairs of the company, its financial position, comments on issues related to the liquidation and the liquidators intentions as to going forward.

This first report is provided to the Registrar of Companies, known creditors and shareholders.

The key responsibilities are:

- Identify and secure company assets;
- Realise those assets;
- Identify creditors, their status and amounts properly owed to each creditor;
- Distribute the proceeds from realisations to creditors and any surplus as required by the Companies Act.

What we do Upon Appointment –Trading Company

Trading companies are usually (not always) closed down. The liquidator can trade the company and may require the director(s) and some staff to assist with trading however the decision to continue to trade is largely based upon what is best in order to maximise the return for the creditors. The requirement is: that the liquidator must carry on the business of a company only to the extent necessary for the liquidation. In other words, the liquidator may carry on the company's business for the purposes of getting in, protecting, and realising the company's assets

In addition to the actions outlined for a non-trading company the trading company scenario has added matters that may require addressing:

- Premises, Stock, plant and equipment and Work in Progress: these will need to be secured by us.
- Staff: we will meet with staff. If the company is to cease trading then the loss of jobs is inevitable.
- Landlord: we will negotiate the terms upon which the company can use the premises for a period of time.
- Asset Valuation: assets may be valued by independent valuers but sometimes this is done by establishing market price at auction.
- Retention of Title Issues: Some assets may have valid retention of title claims in which case we will deal with these claims.

Company Creditors

Upon appointment of a liquidator the company is run by the liquidator. All creditor enquiries must go through the liquidator. This has the benefit of relieving directors of some of the stress they may have been under if the company was unable to pay its debts.

It is important to note that liquidation does not bring to an end any personal guarantees directors or shareholders may have provided creditors at any time prior to liquidation.

Creditors have to establish with the liquidator within certain time frames their right to any claim they may have and their status and any registered securities over company assets.

Duty to have regard to views of creditors and shareholders

The liquidator must have regard to—

(a) The views of the shareholders by whom any special resolution was passed at a meeting held for the purposes of section 241(2)(a) of this Act set out in a resolution passed at that meeting:

(b) The views of creditors set out in any resolution passed at a meeting held for the purposes of section 243 of this Act:

(c) The views of creditors or shareholders set out in a resolution passed at a meeting called in accordance with subsection (2) of this section:

(d) The views of any liquidation committee given in writing to the liquidator.

A liquidator is not obliged to act in accordance with the views of the creditors or shareholders, but the liquidator would not ordinarily wish to be seen to be acting in direct conflict with those views unless he or she has good reason for doing so.

Creditor Meetings

An initial creditors' meeting does not have to be convened where the board has resolved that the company will be able to pay its debts at the date of the liquidator's appointment under s 243(8), or the liquidator considers that no such meeting should be held and the appropriate notices have been sent to creditors without any requirement for such a meeting being received from a creditor within the prescribed period: It is not normal for a liquidator to call a meeting where the dividend available to unsecured creditors (not being Schedule 7 preferential creditors) is likely to be less than 20c in the dollar.

The principal purpose of the initial creditors' meeting is:

(a) To determine whether another person should be appointed liquidator and if so to make that appointment (in the case of a liquidation initiated by shareholder or board resolution); or

(b) To determine whether to make an application to the Court for the appointment of another person as liquidator in place of the person appointed by the Court to that office (in the case of a Court ordered liquidation).

Where the liquidation has been initiated by shareholder or board resolution, the initial creditors' meeting is to be held within 10 working days of the liquidator's appointment or such longer period as the Court may permit.

Where the company has been put into liquidation by Court order, the initial creditors' meeting is to be held within 30 working days of the liquidator's appointment or such longer period as the Court may permit.

However, if the liquidator has decided not to call an initial creditors' meeting under s 245 but a creditor requires such a meeting to be convened (under the requirements of the same section), then a meeting is to be held within 15 working days after the liquidator receives such notice from the creditor.

Liquidation Committees

(1) A liquidation committee must consist of not less than 3 persons who are—

(a) Creditors or shareholders; or

(b) Persons holding general powers of attorney from creditors or shareholders; or

(c) Authorised directors or representatives of companies which are creditors or shareholders of the company in liquidation.

(2) A liquidation committee has the power to—

(a) Call for reports from the liquidator on the progress of the liquidation:

(b) Call a meeting of creditors or of shareholders:

(c) Apply to the Court under section 284 and section 286 of this Act:

(d) Assist the liquidator as appropriate in the conduct of the liquidation.

Membership of a liquidation committee has duties and responsibilities which must not conflict with a member's dealings with the company in liquidation.

Regulations prohibit any member of a liquidation committee, without leave of the Court:

(a) To be paid for being a member of the committee;

(b) To be paid for services rendered in connection with the administration of the company's assets;

(c) From deriving benefit from any transaction arising out of the assets of the company; and

(d) Purchasing any asset of the company.

How to Appointment Norrie & Daughters

Services

Norrie & Daughters will provide the necessary person(s) to act as liquidator, facilitators of informal/formal creditor compromises, and receivers.

Costs

Each assignment cost is estimated on the basis of disclosures provided to Norrie & Daughters before acceptance of the assignment. We maintain the right to alter our estimate and charges. Usually a deposit or payment in full up front is required but not always.

Costs can accelerate upwards very quickly if the directors, creditors, secured creditors etc actions may cause extra work to be incurred. It is not possible at the quotation stage to predict these events. Whilst we try to deal with legal issues in house there sometime when difficulties arise comes a time when it is best to engage outside legal support resulting in additional and unexpected legal costs to be incurred by the liquidators and these costs are added to our account.

In many cases we recover our fees from the liquidation itself but this is not always possible. We can discuss in detail the likely fees during our meeting with you.

Appointment as Liquidator

We need to know the name of the company and whether it is a solvent or insolvent liquidation. From there we will prepare the necessary documentation to commence acting as liquidator.

The liquidator is by law a person(s) working for Norrie & Daughters.

Free Discussion

We offer a free meeting of up to 1 hour to discuss your requirements and answer your questions. This does not have to be face to face but can be conducted over the phone or via other electronic means.

Affiliations

Norrie & Daughters liquidation staff are members of INSOL New Zealand. INSOL New Zealand is a group whose members are also members of INSOL International, a world-wide federation of national associations for accountants and lawyers who specialise in turnaround and insolvency. INSOL New Zealand is closely affiliated with the New Zealand Institute of Chartered Accountants.