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NZ LAW Stronger Together.

Creditor compromise regime

Another option in insolvency

When a company is struggling to pay its bills, 'insolvency' and 'reckless trading' are frightening words that may be thrown around the table. On 3 April 2020, as the first wave of Covid lockdowns hit, the government introduced a brief 'safe harbour' regime. Its purpose was to protect directors of New Zealand companies from being held liable for trying to stay afloat and it permitted a company to trade whilst technically insolvent. This protection was removed on 30 September 2020.

In this article we discuss an alternative to liquidation or receivership. Using the 'creditor compromise' regime can return better outcomes for both the company and its creditors.

When is a company 'insolvent'?

A company is considered insolvent when it cannot pay all debts as they fall due or the total debts of the company are greater than its total assets. The company could be recklessly trading if the directors allow the business to be carried on in a manner likely to create a substantial risk of serious loss to the company's creditors.

Allowing a company to trade when it is insolvent can put the directors at risk of being held personally liable for reckless trading. The directors could also be personally liable if they allow the company to incur an obligation unless they reasonably believe the company will be able to perform that obligation when required. The consequences of reckless trading or breaching those director obligations can be significant. In the well-publicised and ongoing Mainzeal case, directors were found personally liable for $36 million after allowing the company to trade recklessly.[1]

Options for an insolvent company

When directors of a company establish that it is no longer solvent, few choices are available. The two most common options are liquidation and receivership. Either option can be voluntary (the company elects to go through the process to ensure compliance with the Companies Act 1993) or involuntary (a creditor or group of creditors may force the company into the process).

1 *Mainzeal Property and Construction Ltd (in liq) v Yan and Others* [2019] NZHC 255

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Receiverships and liquidations have very detailed processes and procedures, and need skilled independent advisors, including lawyers, accountants and insolvency professionals, to guide the company through the process and liaise with creditors.

There is, however, another choice that may be appropriate for a company facing insolvency.

What is a creditor compromise?

Creditor compromise is a lesser-known option that is available when a company cannot meet its debts. The company proposes an alternative (the 'compromise') to all creditors, such as forgiveness of part of the debt or extended timeframes for repayment, and then calls for all creditors to vote on the compromise. If passed, all the creditors are bound to that compromise, and cannot put the company into liquidation or receivership.

It is important when entering into a creditor compromise that the directors are confident the company can commit to the terms of the compromise; failing to meet the terms could lead to significant consequences for the company and its directors, including personal liability for reckless trading.

A creditor compromise can be preferable for a company and its directors for many reasons. No public notice is required, and the terms of the compromise are often kept private therefore reducing reputational damage to the company.

Aside from those obvious advantages, a creditor compromise also allows the directors to retain control over the company and its assets, the compromise is binding on all creditors, and it can provide a means for the company to slowly return to solvent trading. For the creditor, the compromise often allows them to receive more in the long run than they would have received under a liquidation.

The process

A creditor compromise follows this process:

1. **Directors drive the process**: A creditor compromise plan is usually driven by the directors. They identify that the company is insolvent, or at risk of being deemed insolvent, and look for a 'compromise' that will allow the company to manage its debts.
2. **Appoint independent manager**: The directors appoint a professional to manage the process and develop the creditor compromise plan. It can be an accountant, lawyer, or insolvency professional (or often, a combination) who are experienced in navigating solvency issues.
3. **Identify classes of creditors**: A critical, and most often litigated, step, is the classification of all creditors into appropriate classes by the independent manager. This usually starts with secured creditors, followed by unsecured creditors. The grouping of creditors into 'classes' is not a straightforward process, and it is crucial to get this right to ensure the creditor compromise is binding.

   The manager must understand features of each creditor such as their dependency on the debt, size of the debt, size of the creditor, the financial strength of each creditor and more.

   As this step can lead to court action, incorrectly classifying the company's creditors can lead to the entire compromise arrangement being overturned by the court and the company being placed into liquidation.[2]
4. **Present the creditor compromise plan for key creditor agreement**: Whilst not a legislative step, once a preferred plan has been outlined most companies find it prudent to engage with their key creditors at this stage to ensure there is agreement to the plan. If key creditors aren't satisfied the plan will give them a better result than liquidation or receivership, the creditor compromise is unlikely to succeed and there is no point progressing further. Sometimes key points of the agreement are negotiated at this point before a final version is circulated to all creditors.
5. **Formally notify all creditors**: Once the creditor compromise plan is finalised, the key information is circulated to *all* the company's creditors. It must include specific information including naming the acting parties, events that have led to the compromise situation, the compromise proposal itself, an assessment of what the creditors would receive in a liquidation (to allow them to compare their options), and a full list of all creditors and the estimated amounts owing. This key information also includes the method by which the creditors can vote. A minimum of five days' notice must be provided to creditors to review the creditor plan and submit their votes.
6. **Vote**: If the creditors vote to approve the plan, it will be binding on *all* creditors regardless of which way they voted. In order to 'pass', at least 50% of the *number* of creditors and 75% of the *value* of the creditors in each class must approve the compromise. If the compromise is not approved, a liquidation or receivership may result.

Regardless of whether you are a director of a company facing insolvency, or a creditor who has discovered a company which is indebted to you has, or may, become insolvent, seeking experienced legal advice on insolvency is key.

Directors will need a good legal or insolvency advisor to discuss all available options to get the best result for the company and its creditors, as well as ensuring there is protection from the risk of an accusation of reckless trading.

As a creditor, an advisor will ensure you are fully informed of all options that could lessen your total losses.

If you would like to know more about how a creditor compromise works, or if your company is heading towards insolvency, please don't hesitate to contact us. +

2 *Trends Publishing International Ltd v Advicewise People Ltd* [2017] NZCA 365

Guest editorial

In another of our occasional Fineprint *guest editorials, we introduce the ANZ's Senior Economist, Miles Workman, who has written on the state of New Zealand's economy. It would be fair to say the economic outlook in the short-to-medium term is not massively rosy, but there is, however, some solace in that the Reserve Bank wants to contain inflation as much as possible.*

The economy – tougher times ahead?

Miles Workman, Senior Economist, ANZ

Global and domestic inflation risks remain intense, but front-loaded official cash rate (OCR) hikes by the Reserve Bank of New Zealand (RBNZ) are mitigating against the risk that inflation continues to go the wrong way.

Many other central banks across the globe are now underway with their tightening cycle too and making all the right noises. ANZ Research fully expects them to tame inflation in time. The question is, how much tightening will it take and how much economic pain will it require?

War, high inflation, acute capacity constraints, falling house prices and weak consumer and business confidence all suggest downside risks to economic activity. But Covid-volatility is making it hard to separate the noise from the signal.

Provided New Zealand manages to avoid lockdowns in 2022, GDP data should settle down over the second half of the year (Q3 GDP data is released in December 2022).

That means Kiwis need to continue to look beyond GDP for a steer on economic momentum. And there are plenty of indicators suggesting underlying momentum is slipping.

Despite the very low unemployment rate, ANZ's Consumer Confidence survey shows confidence is softer than during the 2008-09 recession, which is not a time retailers remember fondly.

While building consents are at high levels, ANZ Research's Business Outlook suggests residential construction is poised to slow. Building cost inflation, construction delays and difficulty achieving presales as house sales and prices fall could very well see some of these consented projects scrapped. Anecdotally, that's happening already.

There are other reasons to think tougher times lie ahead:

+ While New Zealanders are now free to travel abroad, international tourism isn't expected to start picking up meaningfully until the 2022-23 summer – so tourist operators could have to navigate through a tough winter.
+ Conditions for key exporters are tough. Key export commodity prices are now slipping with global consumers less willing, or able, to pay top dollar for our produce. Soaring fertiliser prices along with difficulties in getting product to market and finding workers are also weighing on agricultural production.
+ Households are going backwards financially as inflation outpaces income growth. While ANZ Research expects growth in real (CPI-adjusted) hourly earnings will be positive by the end of the year, it's a mixed blessing for the RBNZ that is, quite rightly, concerned about the possibility of a wage-price spiral developing.

All up, the drivers of economic momentum are particularly complex right now.

Overall, 2022 (which still has some Covid-related volatility to work through) should see GDP growth come in a little below trend (2.2% over the year to December), slipping further in 2023 (2.0%) and 2024 (1.7%). Risks to growth are to the downside.

Inflation will ease; it's just a question of how high rates need to go (and for how long)

At around 7% year on year, CPI inflation is running at a 30-year high. While there are some significant inflation pressures stemming from global developments, domestic inflation is the primary concern for the RBNZ.

Non-tradables inflation (aka domestic inflation) is running closer to 6% year on year. This is the sticky kind of inflation that tends to be difficult to tame, and right now it's far too high to be consistent with the RBNZ's inflation target.

ANZ Research expects OCR hikes, supported by the general monetary tightening underway globally, will successfully take the heat out of inflation in time.

Given current inflation and capacity stretch, ANZ Research expects the RBNZ to deliver more out-sized (50 basis point) hikes in the near term, before pivoting to 25 basis point hikes from October, taking the OCR to a peak of 3.5% in November 2022.

It's a fine balance for the RBNZ as it weighs up the risk of oversteering (engineering a hard landing for housing, economic activity and inflation) against ensuring inflation pressures don't spiral out of control.

All up, the rebalancing act the RBNZ and other central banks are currently performing is riddled with risks and uncertainties. But the one thing we can be sure of is that they will be successful in taming inflation, it's just a question of how high (and for how long) rates need to go.

The views and opinions expressed in this communication are those of the author and may not necessarily state or reflect those of ANZ. +

Love, heartbreak and … death?

Make a new will and EPAs when you separate

Many people who have endured a relationship break up know it can be exhausting – mentally, emotionally, physically and, ultimately, financially. You could be forgiven, then, for thinking the priority is to get the agreements signed or Court Orders made. However, what is often overlooked as one of the first steps, and yet so imperative to protect your assets and your new spouse, partner or children in the future, is updating your will and enduring powers of attorney (EPA) to reflect your new relationship status.

Why update your will?

There are some very good reasons why you should update your will if you separate, including:

+ Your ex-spouse/partner may still benefit under your will as it continues to be effective after you separate unless:
  - You remarry or form a civil union
  - You make a new will, or
  - The court orders otherwise.
+ If your marriage or civil union hasn't been formally dissolved, everything remains the same (which is why you need to change your will after separation). If your marriage or civil union has been dissolved, however, your ex-spouse/partner can neither be an executor nor a beneficiary.

Those people whom you would like to benefit (such as your new spouse or partner, children or grandchildren) may have to share your estate with your ex-spouse/partner unless they can persuade them to waive their entitlement under your will by entering a deed of family arrangement. If your ex-spouse/partner refuses to waive their entitlement then your family would need to resort to a claim in the Family Court for additional provision from your estate, such as:

+ A claim by your new spouse/partner, children or grandchildren under the Family Protection Act 1955, or
+ A claim by your new spouse/partner under the Property (Relationships) Act 1976.

None of the above options will be easy, and all of them could be lengthy, litigious and expensive. If you wish to ensure those people you would like to benefit when you die do in fact benefit, your first task should be to instruct your lawyer to make a new will that reflects your newly separated situation.

Appointing a testamentary guardian?

If you separate, you can ensure someone you trust will look after your children's best interests and welfare after you die by appointing a 'testamentary guardian' in your will. Your testamentary guardian will have the power to make guardianship decisions about your children.

This is particularly important if any other legal guardians (such as your children's other parent or existing court-appointed guardians) are not so suitable.

Appointing a testamentary guardian gives that guardian the *right* to apply for day-to-day care, it does not necessarily mean they will *have* the day-to-day care of your children after you die. However, if the testamentary guardian was the primary caregiver prior to your death, and it is not in the children's best interests and welfare to be placed in the care of any other legal guardians, then the court may well grant the testamentary guardian day-to-day care.

A testamentary guardian should be someone you consider a good role model for your children. That person should be in the best position, financially and emotionally, to help care for them, be in good health and be able to ensure continuity of care for your children so they are not uplifted from their education, social group or community. Make sure you talk with your proposed guardian to ensure they can tick all these boxes before making this appointment in your will.

Why update your EPA?

If you appointed your ex-spouse/partner as your attorney in respect of EPAs for personal care and welfare and/or property, this is also not automatically revoked when you separate. It's a similar situation as overlooking making a new will when you separate – retaining an out-of-date EPA could create a very awkward family reunion if your ex spouse/partner remains responsible for making decisions about your personal matters (which doesn't include decisions about your children) if you lose mental capacity.

If you do not revoke your EPA after you separate, and subsequently lose mental capacity, unless the appointment of your ex spouse/partner ceases (because your ex dies, becomes mentally incapable, bankrupt, or files a notice in court under the Protection of Personal and Property Rights Act 1988), the only option to remove an attorney is for your family to apply to the Family Court.

The better option? Revoke your EPAs and make new ones with your lawyer at the same time you update your will.

Do it sooner rather than later

Understandably, the idea of more legalities after a separation can be daunting and easily pushed to the back of your mind. Ignoring these issues may be easy to justify after the rigours of a separation. Ultimately, however, by not being thorough post-separation, which includes re-arranging your estate planning, you are leaving a potentially complex and expensive legal headache behind for your loved ones and much uncertainty for your children.

Get onto this sooner rather than later – the risk isn't worth it. +

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New Incorporated Societies Act 2022

Important changes and timeframes

The new Incorporated Societies Act 2022 received Royal Assent on 5 April 2022 replacing the very old Incorporated Societies Act 1908.

With 23,000+ incorporated societies in New Zealand, many of us will have some involvement with these organisations and we should be aware of the important changes and timeframes involved in complying with this new legislation.

The 2022 Act provides for a transitional period ending on 1 December 2025. By then every existing incorporated society must have decided whether to retain its incorporated status by seeking reregistration. If it opts to reregister, it must check that its constitution (the rules of the society) comply with the requirement of the new Act; failing to register may result in the incorporated society ceasing to be registered and unable to operate.

New requirements

The new legislation requires incorporated societies to:

+ Introduce a requirement to have a committee with three or more officers.
+ Specify certain factors that will disqualify a person from being an officer, such as being an undischarged bankrupt or being convicted of a crime involving dishonesty within the last seven years.
+ Introduce duties for officers that will result in them having duties akin to those of company directors. All officers must:
  - Act in good faith and in the best interests of the incorporated society
  - Exercise their powers for proper purposes
  - Exercise the care and diligence that a reasonable person with the same responsibilities would in the same circumstances
  - Not agree, cause, or allow the activities of the incorporated society to be carried on in a manner that is likely to create a substantial risk of serious loss to creditors
  - Not agree to the incorporated society incurring an obligation unless the officer believes on reasonable grounds that the incorporated society will be able to perform the obligation when required to do so, and
  - Not act, or agree to the incorporated society acting, in a manner that contravenes the 2022 Act or its own constitution.
+ Allow a mechanism for members to obtain information from officers to allow for improved accountability of those officers.
+ Provide for certain criminal offences, such as officers dishonestly using their position, fraudulently using incorporated society property and falsifying records, documents or the Incorporated Societies Register.
+ Prescribe that the annual financial statements must be prepared and registered, and prescribe the required reporting standards that are dependent on the size of the incorporated society.
+ Prescribe that large incorporated societies, as set out in the Regulations (still to be published), are required to have their financial statements audited.
+ Have an ongoing minimum number of at least 10 members (the 1908 Act only requires a minimum number on incorporation). Members must consent to become a member and incorporated societies must ensure they have processes to ask for, and record, that consent.
+ Include a dispute resolution procedure in their constitution.

These changes are significant. Existing societies should start reviewing their position in light of the new legislation as soon as possible.

If you would like some guidance with this process, please be in touch with us. We are here to help.

Postscript

Fair Pay Agreements Bill

The Fair Pay Agreements Bill was introduced earlier this year; it proposes a framework for collective bargaining of fair pay agreements. The Select Committee is working its way through submissions and will report back to the House in early October.

The government believes the current situation of an employer and employee being free to negotiate the terms of employment without being subject to fair pay obligations (provided employment law minimum entitlements are met) marginalises some employees. The draft legislation would introduce a regime where an agreement is established across an entire industry or occupation for mandatory minimum employment terms (such as wages or hours of work).

It is fair to say, no pun intended, that the proposed legislation has not been met with open arms by employers. Unions, however, have greeted the provisions in this Bill much more positively. We will let you know the status of this legislation in the next edition of *Fineprint*. +

Scams: be vigilant

Scams affect us all – in our bank accounts, credit cards, over the phone, social media, via email or simply being sent a 'strange' communication offering you some 'benefit.'

If you are contacted unexpectedly – always hesitate and consider that a communication from someone you don't know could be a scam. Never, ever click on a link that you don't know. Keep an eye on your credit card statement; unsavoury characters can hack your credit card details and 'phish' your money in the blink of an eye.

For help and information on scams, go to **www.consumerprotection.govt.nz** and click on the Scamwatch button. Netsafe New Zealand is also very helpful, go to **www.netsafe.org.nz** +

New whistleblowing legislation now in force

The new Protected Disclosures (Protection of Whistleblowers) Act 2022 came into force on 1 July.

The government says this new legislation provides clearer protection for people to speak up about wrongdoing, while protecting the whistleblowers themselves. It ensures confidentiality around who has made the disclosure, immunity from disciplinary action for making the disclosure and protection from retaliation through the Employment Relations Act 2000 and the Human Rights Act 1993.

If your business hasn't already done so, we recommend you urgently review your whistleblowing policies and procedures so they comply with this new legislation. If you would like some help with this, please be in touch. +

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