Meltzer Mason Heath

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UPDATE + NEWS + REVIEW

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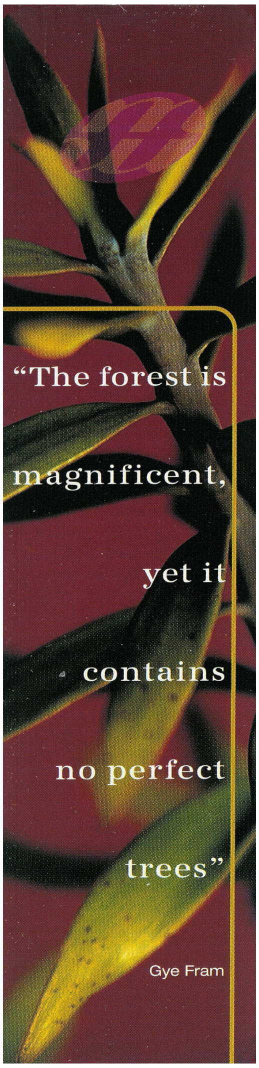

"If past history was all there was to the game, the richest people would be librarians."
Warren Buffett

Voluntary Administration Revisited

Jeff Meltzer

In our April 2009 newsletter I gave my thoughts on the advantages and disadvantages of a Compromise with Creditors ("Compromise") compared with Voluntary Administration ("VA"). In this newsletter I provide an update on my views.

When a company enters into VA control passes to the Administrator and the directors' powers are suspended during the administration process. The words "Administrator Appointed" are to be attached to the company name and to appear on all company correspondence from the date of the appointment and the appointment of the Administrator is publicly advertised. This can be considered an unfortunate stigma which attaches to companies under VA and there is a common view that this signifies that such companies are not only insolvent but beyond all likelihood of rescue.

By contrast, in a Compromise the directors continue to undertake their functions during the Compromise period. No additional words are added to the company's name during the period of the Compromise and there is no requirement for public notice.

The objective of a Compromise and of a VA is to maximise the chances of a company being able to continue to trade and to remain in business or if that is not possible then to find a better return for the company's creditors than they would otherwise receive in a liquidation.

Under a Compromise and a VA the company can be given a second chance. In a VA a moratorium is imposed over the company's creditors until the watershed meeting is held 28 working days after the appointment to consider a Deed of Company Arrangement ("DOCA"). During this period Court proceedings cannot be commenced or continued against the company without the consent of the Administrator or the leave of the Court. This gives a valuable breathing space and time to focus upon saving the company rather than focussing on claims which creditors may bring. There is no automatic moratorium or stay of Court proceedings during the consideration of a Compromise but application can be made to the Court for a stay once notice of the proposed compromise has been given. Of course both the moratorium and stay of proceedings will be key components of the Compromise proposal to be put to creditors.

As I have previously pointed out a VA is publicly advertised and consequently the company/Administrator may have difficulty obtaining credit from suppliers and there is the risk of competitors approaching customers during the period of the administration.

What is the role of the directors during a Compromise and a VA?

In a VA control of the company is passed to the Administrator. The directors of a company in VA will be afforded protection from personal liability during the period of the administration for insolvent trading and from enforcement of any guarantee they may have given. However, the directors will not be able to participate in or influence the affairs of the company during the VA. The Administrator's duty is to the company's creditors not to the directors and the Administrator has a duty to investigate the actions of the directors and report to the Registrar of Companies on whether the directors have engaged in any improper business activity.

During the period that a Compromise is operating the directors remain in office and continue to administer the company's affairs during the Compromise period. Personal liability for insolvent trading continues during this period. The Compromise Manager acts as a conduit between the company and its creditors but does not become involved in the management of the company, nor is the Compromise Manager or proposed Compromise Manager under any duty to investigate the actions of the directors.

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Once an Administrator is appointed there are two options for the future of the company. There is no guarantee of a positive outcome and if a DOCA is not approved by the creditors then the options for the company are either for the administration to end or for the company to be placed into liquidation. Experience with New Zealand administrations so far is that if a DOCA is not proposed and approved the company is placed in liquidation. If a Compromise is not approved by creditors the directors of the company are still in control and may still have the ability to consider other options for the future of the company. If directors suspect their company may be in significant financial difficulty or may be approaching insolvency then it is incumbent upon directors to take positive steps to address the problems. Professional financial and legal advice must be obtained along with consideration of all of the options that are available to the directors. Following this path and this advice directors are less likely to run the risk of liability for insolvent trading. A Compromise or a VA should not be seen as a sign of failure or admission of defeat on the part of directors but rather it should be viewed as a means of resolving the future of the company and in many cases giving the company the opportunity of getting back on track and out of its financial difficulties.

Observations on the Creditor Compromise and Voluntary Administration Processes

Arron Heath

In our opinion the Compromise procedure set out in Part XIV of the Companies Act 1993 has been significantly overlooked by companies and their advisors as a means of restructuring and reorganising their affairs. While the introduction of the VA regime has been a welcome addition to corporate insolvency techniques, it is an expensive process requiring two creditors' meetings and is, perhaps, better suited to larger corporates. The main benefit of the VA procedure is the automatic moratorium and that, in itself, may be sufficient to justify the appointment of administrators. However, VA may not always be the most appropriate procedure to achieve the objectives outlined in paragraph four, above.

But, the major problem confronting a Compromise proponent is the liability facing directors who permit a company to trade while insolvent. In the context of a Compromise, as a minimum, such trading would encompass the period from commencing the process to formulate the proposal to creditors up to the creditors' approval of the Compromise. (It should be noted that the Courts have not interpreted the reckless trading provision of the Companies Act as operating to require the directors to shut down a company's business at the first sign of financial problems. However, the directors are required to address the problems facing the company and, if these cannot be resolved, then to cease trading.)

This conundrum has been recognised in Australia where discussions have suggested that a "safe harbour" regime could be introduced which would protect directors from liability for insolvent trading while pursuing a work out for the benefit of creditors. The safe harbour regime would operate either through a business judgement rule or a moratorium on insolvent trading with the director's business judgement being that the interests of the company's creditors as well as members were best served by pursuing restructuring.

Such a regime should also be looked at in New Zealand in order to protect directors from the threat of personal liability for reckless trading or other breach of duty owed to the company, while making bona fide attempts at reorganisation outside of the VA procedure.

Where is the Recovery?

Arron Heath

The latest MYOB Business Monitor report revealed that a third of the small and medium firms monitored suffered falling revenues over the 12 months to April 2010 with a third also reporting a fall in profitability. MYOB's conclusion was that business owners appeared to have adopted a more conservative view of the recovery as more businesses faced falling revenues.

Interestingly, and as referred to in previous newsletters, cash flow was still expected to be a problem. The report stated that "exchange rates, interest rates and access to business finance, have again come to the fore as key business pressures".

It appears that many businesses are still working through the effects of the recession and are not looking to expand resources in the near future. Funding working capital requirements remains a problem and cash flow forecasting and monitoring will be a vital part of business management for some time to come.

Between the professional staff at Meltzer Mason Heath there is over 100 years insolvency experience. This means that any problems or uncertainties facing your clients are likely to have been seen by us before. Please call us, and as always we will offer you and/or your clients a free one hour consultation.

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