

Businesses Facing Cashflow Difficulties

Recovery or Insolvency?

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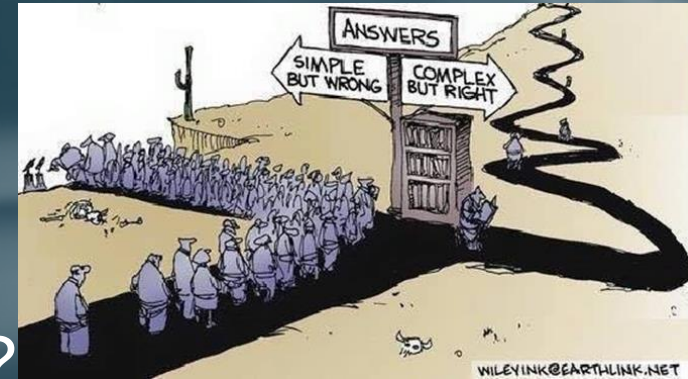
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Preliminary Questions

- What has caused cashflow problems?
 - Primary reason
 - Other contributing factors
- Who is going to be affected?
- Am I dealing with a short term or long term issue?
- How quickly do I need to act?
- Is there help available?



Looking at Debtors with Cashflow Difficulties

Debtor

- Who?
- Debt owing?
- Likely to be recovered?
- Likely timeframe for recovery?
- Other options for recovery?

Debtor's Customers

- Who?
- Ability to spend?
- Pricing?
- Demand for goods/services?
- Credit limits?
- Cash sales?
- State of current relationship?

Impact of Debtor's Cashflow Difficulties on Third Parties

Creditors

- Who?
- Debt owing?
- Type of creditor?
- Essential to the business?
- State of current relationship?
- Pressure being applied?

Suppliers

- Who?
- Debt owing?
- Essential to the business?
- State of current relationship?
- Alternatives?

Creditor Types

Secured Creditor

- General Security Agreement
 - All present and after acquired personal property
 - Business
 - Physical assets
 - Intangible assets
- Purchase Money Security Interest
 - Specific property
 - Supplied to company
 - Stock
 - Inventory
 - Owned or leased
 - Vehicles
 - Plant and machinery
 - Proceeds of sale

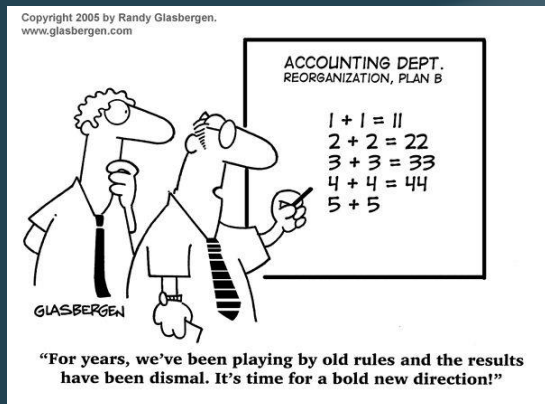
Unsecured Creditor

- Preferential creditors
 - Schedule 7 of the Companies Act
 - Liquidators' fees
 - Court costs on liquidation application
 - Creditors who fund recoveries and protect assets
 - Wages (up to 4 months before liquidation), holiday pay, redundancy pay (contractual), and KiwiSaver
 - GST, PAYE, NRWT, WRT, and duty (customs)
- Non-preferential unsecured creditors
 - Trade creditors
 - Shortfall owing to secured creditor
 - Shareholder advances
 - Non-preferential employee claims (hurt and humiliation, older wages, notice period)

Cashflow Difficulties – What’s Happening Inside the Business

Triggering Event

- Debtor’s insolvency
 - Debtors not paying on time, as promised, or agreed
 - Debtor enters insolvency process
- Unexpected expenses
 - Broken or damaged equipment
 - Supplier price increase
 - Investigation or prosecution
 - Dispute
 - Supplier
 - Employee
 - Customer
- Key loss
 - Personnel
 - Supplier
 - Contract
 - Product

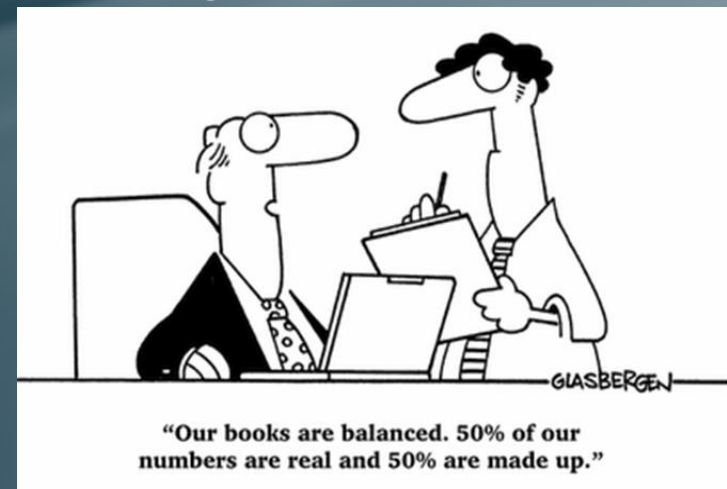


Gradual Decline in Performance

- Management and/or key staff in denial
 - Financial situation being ignored
 - Management accounts and financials are not up to date / complete
 - IRD obligations in arrears
- Debt collection issues
 - Company not collecting its own debtors promptly
 - Company “relying on” irrecoverable debts
- Pressure from creditors re accounts in arrears
- Shareholder drawings / current account

Warning Signs – What Creditors See

- Late payments, part payments, and debt on account increasing
- Promises to pay / payment arrangements are broken
- Difficulty contacting the company / key staff
 - Key staff are not available / out of the office
 - Phone calls, letters, emails are ignored / go unanswered
- Outward appearance does not match financial performance - company appears to be going well / shareholders are spending money but creditors are not being paid



Protect Yourself – What Can Creditors Do?

Documentation

- Signed credit application
- Terms of trade
- Personal guarantees
- Registered financing statements (PPSR)
 - Valid security
 - Compliance with PPSA requirements for type of security
 - Priority rights
 - Renewals
 - Re-registration after name change



Terms of Trade

- PMSI and/or GSA
- Right to appoint receivers
- Retention of title / security over goods supplied
- Right to trace into proceeds
- Right to check credit history
- Right to inspect company's financial records
- Right to charge interest and/or debt collection costs
- Credit limits / stop credit
 - Is the current level appropriate?
 - Do you need to notify any change?

Protect Yourself – What Can Creditors Do?

Processes

- Debt collection processes and procedures
 - Internal
 - Are your terms and your debt collection processes consistent?
 - What terms say re payment
 - When are customers paying
 - Is the process working?
 - External
 - Is the process working?
 - Is it tailored?
 - Cost?
- Are you taking advantages of your rights under your terms of trade?
 - Right to information
 - Registrations on PPSR



Practical Considerations

- Registering financing statements
 - Timing of registration and of supply
 - Loss of PMSI priority
 - Sufficient detail
 - Right name and party
- Age / recoverability of debts
 - Likelihood of recovery
 - Ability to repossess goods and / or recover proceeds
- Market realities
 - Availability of credit
 - Issues facing the industry
 - State of the market
- Market perception
 - Are you proactive?
 - Efficiency of debt collection procedures
- Debt factoring by debtors
 - Impact on the right to trace into proceeds
- Insolvent transactions

Insolvent Transactions and Charges

- Transaction entered into when company unable to pay its due debts and the transaction enables creditor to receive more than he / she / it would likely receive in the company's liquidation
 - Restricted period – 6 months
 - Related party period – 2 years
 - Defined in section 291A
- Defences to recovery
 - Good faith
 - Post-charge advances and supply actually provided to debtor after charge given
 - Gave value
 - Hard for liquidators to challenge re suppliers
 - No knowledge of insolvency
- Prepayments / cash on delivery?
 - OK because no debtor / creditor relationship



Insolvent Transactions – Knowledge of Insolvency

- A reasonable person in the creditor's position would not have suspected, and the creditor did not have reasonable grounds for suspecting, that the company was or would become insolvent
- Knowledge / suspicion of insolvency
 - Operating outside credit limit
 - Debtor on stop credit
 - Timing of invoices and payments
 - Change in timing of payment by debtor
 - Payment arrangement in place
 - Broken promises to pay
 - Other creditors not being paid
 - Pay when paid



Informal Creditor Management

- Deals with creditors on a piecemeal basis
- Success depends on how many creditors involved and who those creditors are
- Issues can arise if “unforeseen” creditors come to light
 - Not enough cash to go around
 - Need to juggle obligations
 - Promises to pay get broken
- The more creditors a company has, the harder it is to informally manage creditors
- Increased risk of claw backs / insolvent transactions, if informal arrangement fails



Turnaround Options – Maximising the value of the business

Debt Hibernation – Cashflow tool	Creditor Compromise – Debt management tool
<ul style="list-style-type: none">• Available until 31 October 2021• Existing debts get parked (not compromised)• Creditors cannot take enforcement steps (GSAs excluded)<ul style="list-style-type: none">• Initial one month period• Six month extension, if creditors approve arrangement• Must be more likely than not that business can pay debts by 31 July 2022	<ul style="list-style-type: none">• Can be with some or all creditors• Creditors divided into and vote in classes• Debts can be compromised on a class by class basis• Repayment period is agreed with creditors• Directors keep control of company
Voluntary Administration – Debt management and/or restructuring tool	Hive Down – Restructuring tool
<ul style="list-style-type: none">• Administrators appointed• Initial moratorium on enforcement (company debts and PGs)• Administrators assess business then make recommendation to creditors• Implementation overseen by Deed Administrators	<ul style="list-style-type: none">• Company placed into liquidation• Company in liquidation responsible for company debts• New company buys business <u>at market value</u>• Purchaser in control of new business• Liquidators deal with vendor's debts

Business Debt Hibernation

Will it Work?

- Requires the business to be more profitable than it was pre-COVID-19
 - Does not allow for debts to be compromised
 - Board must consider that entity's debts can be paid by 31 July 2022
- Requires at least half of company's creditors to agree
 - Lower threshold than compromises and deeds of company arrangement
- Debt hibernation prevents:
 - Guarantees being enforced
 - Company property from being repossessed without the High Court's permission
 - Unless creditor has GSA

Creditor Considerations

- Is it a cashflow issue?
- Is it a pathway to the company entering into another insolvency process?
- Voidable preference regime does not apply to arm's length transactions entered into in good faith with BDH entity
 - Encourage creditors to continue trading with BDH entity

Company Compromise

Will it Work?

- Requires a good underlying business
- Relatively quick and inexpensive to put together and implement
- Trust is crucial
- Debtor must provide sufficient information so that creditors can make an informed decision on whether the proposal is in their best interests
 - Full disclosure of debtor's predicament
 - Transparent explanation
- No moratorium on creditors taking enforcement action (unless court ordered)
- Compromise can be put to some or all classes of creditors

Creditor Considerations

- Is the compromise my best option?
- Am I in the right group?
 - Creditors are grouped into classes and vote in these classes
 - Common interests
 - How rights are affected – legal and/or economic
 - Classes of creditors can be treated differently and/or offered different deals
- Are there “insider creditors” in my group?
 - Creditors whose interests do not conform to the interests of the class of creditors (related parties)
 - Not affected economically
- Company compromise does not affect ability to enforce against company's guarantors

Voluntary Administration

Will it Work?

- Moratorium (including personal guarantees) while administrators investigate company's affairs then recommend course of action to creditors (for their approval)
 - Execute Deed of Company Arrangement (DOCA)
 - End administration
 - Liquidate company
- Candidates for DOCA:
 - Good underlying business
 - Ability to generate income sufficient to fund DOCA
- Requires wide creditor support for DOCA
 - Affects all creditors (no class voting)
 - Company continues to trade under supervision / control of the administrators
 - Each creditor decides whether to continue to supply company during DOCA period

Creditor Considerations

- Does continuing to trade under DOCA provide a better return than liquidation?
 - Ability to complete partly complete jobs and recover WIP
 - Ability to fulfil forward contracts
- Is the issue the business or management?
 - Administrators are independent
 - Administrators have ultimate control of business and its management
 - What role does existing management play under DOCA
- Am I a critical supplier? Am I prepared to continue supply?
 - Benefits and risk of providing further supply
 - DOCA can provide for trading on payments to be prioritised over pre-DOCA debts
- DOCA does not prevent creditors from enforcing personal guarantees

Hive Down

Will it Work?

- Requires at least part of the business to be viable
- After old company is liquidated, business (or part) is purchased at market value by new company (related party sale)
 - Debt stays with old company
 - New company starts fresh
 - Purchase price may allow a distribution to be made to liquidated company's creditors
- Little disruption to day to day business and ability to trade
- Requires the support of key creditors
 - Bank
 - Landlord
 - Critical suppliers
 - Creditors with personal guarantees?



Creditor Considerations

- No requirement for company to reach any creditor approval threshold
 - Creditors who do not agree cannot prevent hive down
- Default position: director of failed company (insolvent liquidation) cannot be director / manager / promoter of new company with same / similar name
 - Breach = personal liability for debts of successor company
- Solution for director: Successor company notice
 - Gives notice to creditors of failed company that person named:
 - was director of failed company
 - will be director/manager/promoter of new company
 - Must be issued within 20 working days
 - If successor company notice is not issued, creditor can pursue director personally for debts incurred by new company

Insolvency Processes – Maximising the value of the business

Receivership – secured assets

- Appointed by a secured creditor under a deed or agreement
 - GSA
 - Terms of trade
- Receivers' powers are as set out in the deed or agreement – no general or default powers given in Receiverships Act
- A default is required but immediate prior notice of receivers' appointment is not
- Receivers realise secured assets
 - Business
 - Physical assets
 - Intangible assets
- Receivers' obligations are to:
 - Secured creditors with higher ranking securities than appointor
 - Higher ranking GSAs
 - PMSI creditors
 - Appointor



Liquidation – unsecured assets

- Can be appointed by:
 - Shareholders
 - Board (if power in constitution)
 - High Court
 - Company
 - Director
 - Shareholder
 - Creditor
- Liquidators can deal with all unsecured assets
 - Assets not covered by valid securities
 - Claims belonging to the liquidators
- Liquidators can only deal with secured assets if the secured creditor consents or liquidators discharge security
- Liquidators obligations are to all creditors
 - Preferential
 - Secured
 - Unsecured



Liquidation – Creditor Considerations

- Appointing interim liquidators is an option if creditor thinks, on reasonable grounds, that the company's assets are at risk
- Creditors can fund the liquidators to take steps:
 - Investigations
 - Expense of the liquidation
 - Recovery actions and preserving assets
 - Creditor's claim becomes a preferential claim in the liquidation, to the value of the recovery made



Liquidation – Creditors' Rights

- Creditors can review appointment of liquidator at first creditors' meeting
 - Creditor must request meeting within 10 working days after receiving notice of liquidators' decision to dispense with first meeting
 - If shareholder appointed, creditors can vote on replacement liquidators
 - If court appointed, creditors can vote to apply to the High Court to replace the liquidators
- With leave, creditors can ask the High Court to:
 - Give directions to liquidators
 - Confirm, reverse, or modify any act or decision
 - Review or fix liquidators' remuneration and require liquidators to refund unreasonable remuneration
 - Order an audit of the liquidators' accounts

Personal Exposure

Personal Guarantees

- Landlord
 - Rent arrears
 - Future rent to end of current lease term
 - Bank bonds
- Bank
 - Cross lending
 - Securities
- Trade creditors
 - Signed terms of trade
 - Separate guarantee document

Options for Insolvent Individuals

1. Sell assets and pay creditors (informal/piecemeal settlements)
2. Part 5 subpart 2 proposal (compromise)
3. Summary Instalment Order (SIO)- debts up to \$50,000
4. No Asset Procedure (NAP) – debts up to \$50,000
5. Bankruptcy



Part 5 Proposals

- Proposal to creditors intended to provide better return to creditors than in bankruptcy
- Successful if majority in number and three-quarters in value of creditors voting vote in favour
 - Successful proposal binds all creditors with debts provable in insolvency's bankruptcy
- Three “typical” proposal debtors
 - No assets but good earning ability so can repay creditors over time
 - No assets of value but ability to get lump sum from third party to pay debts
 - Assets with no/little equity but better realisable value if sold over time

What Can You Do?

- Set and enforce credit limits
 - Stop credit
 - Cash on delivery
- Be proactive with credit control and chasing overdue debts
- Engage good professional advice
- Regularly review terms of trade
- Use protections in terms of trade
 - Registering security interests on the PPSR
 - Tracing
 - Inspection of debtor's documents
 - Right to appoint receivers

Government – COVID-19 Support

- Government guaranteed loans (up to \$500k)
- Small business cashflow loans
 - \$10,000 plus \$1,800 per FTE employee
 - Open until 31 December 2023
- MSD wage subsidy
 - Can be used for wages only
 - Applied for and paid in two week blocks
- Resurgence Support payment
 - For business expenses
 - Applied for and paid in three week blocks
- Short term absence and leave support payments
 - One off payments for employees waiting for COVID-19 test results
 - Fortnightly payments for employees required to self isolate because of COVID-19
- Bank payment reductions and deferrals
- IRD COVID-19 interest write offs

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