

Creditor Compromises and Business Debt Hibernation

Craig Sanson and Marcus McMillan

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Part 14 - Creditor Compromises



Overview of the compromise process

Types of Compromise

Two types of creditor compromise specified in Part 14 and Part 15 of the Companies Act 1993.

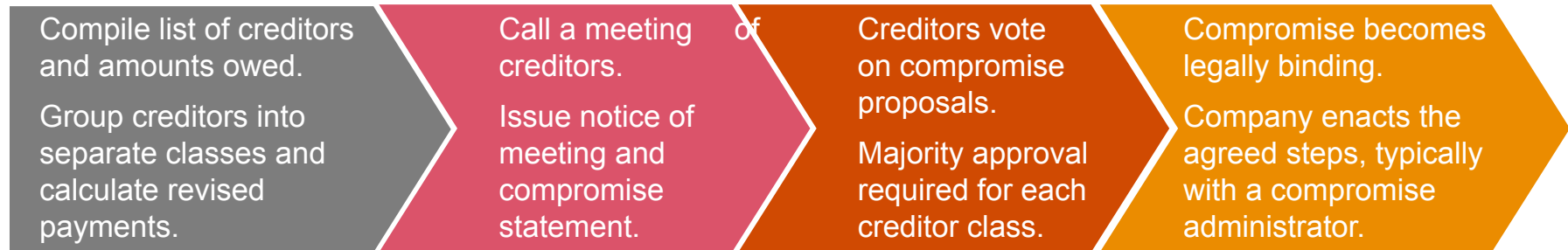
- Part 14 is a formal arrangement made between a company and its creditors
- Part 15 is supervised and approved by the court.

Companies can also seek to reach informal compromise agreements with creditors outside this framework.

“A compromise is a means by which an indebted company may reach an arrangement with its creditors to pay them less than the full amount owing or to pay the amount owing over an extended period of time.”

New Zealand Companies Office

Compromise Process



Legal requirements

Proposal

- **The board of Directors of the Company**
- A receiver
- A liquidator
- With the leave of the court, any creditor or shareholder of the company

Approval

- Proposal must be approved by **50%** majority in number
- Proposal must be approved by **75%** majority in value
- If different classes of creditors are present, **majority must be within each class**
- Decision of majority is imposed on minority

Part 15

- Broadly similar in nature, but requires court approval in process
- More suitable where there is more shareholder involvement

Pros and Cons

Why use them?

- 01 Flexible
- 02 Doesn't finalise the company - allows corporate continuation & turnaround
- 03 Lower costs and improved return to creditors versus formal insolvency
- 04 Current economic environment may be receptive

Why not use them?

- 01 Duplication of cost if unsuccessful and formal process is required
- 02 Won't be approved if creditors have adverse view of company / directors
- 03 Distinguishing creditors into classes can be problematic
- 04 Tax consequences

Practical considerations

Pre-compromise steps

- Complete assessment of alternatives (e.g. receivership or liquidation);
- Obtain support from secured creditor;
- Calculate working capital requirements for compromise process
- Engage and communicate with creditors and determine specific approaches for each class
- Verify accuracy and completeness of data

Documentation requirements

Proposal must contain certain information – S229 (notice of meeting, statement of proposal, list of creditors with amounts, etc)

Notice of the outcome must be provided to all creditors, Registrar, receiver / liquidator

Creditors

Dissatisfied creditors may apply to Court to be excluded from compromise in the following circumstances:

- Insufficient notice of the meeting was given (not less than 5 working days);
- Material irregularity in obtaining approval; or
- Creditor would be unfairly prejudiced

Compromise case study

Compromise agreement for Hawke's Bay vineyard & winery

- Parent company withdrew funding support and company was unable to secure further financing;
- Secured creditor with GSA - alternative scenario would be receivership with no additional funding;
- Proposed moratorium period to market business as going concern and run sales process;
- Secured creditor reserved position and expected to be paid from subsequent sales process;
- Unsecured creditors receive first \$500 of claim, and a further 20c in the \$ for other balances

Business Debt Hibernation





Going into a Business Debt Hibernation will give businesses the space to talk to their creditors about prioritising paying some debts, and deferring others for six months.

Grant Robertson
Minister of Finance



Business Debt Hibernation

Eligibility Criteria

As at 31 December 2019, the business was able to pay its debts

At least 80 per cent of the directors (or equivalent) agree that it may do so

The entity has, or in the next 6 months is likely to have, significant liquidity problems

The liquidity problems are, or will be, a result of the effects of COVID-19 on the entity, its debtors, or its creditors

It is more likely than not that the entity will be able to pay its due debts on and after 30 September 2021

Business Debt Hibernation - Timeline

Apply for Business Debt Hibernation

- Determine if business meets the **threshold** -
- Submit the BDH entry notice

Plan for the creditor proposal

- The business enters into **1 month** moratorium when BDH Entry Notice is delivered to the Registrar (cls 6)

Submit the creditor proposal

- Send **proposed arrangement** and, provide at least **five working days** before the voting deadline

Creditor Decision Notice (receive and count votes)

- Approved - BDH is extended by further **6 months**
- Not Approved - BDH ends

Excluded Creditors

GSA holder

GSA holders are not bound by the moratorium. Can still enforce under GSA. May still be eligible to vote.

Employees

Employee debts are excluded from the hibernation and can not vote.

PAYE

PAYE including (Kiwisaver etc.) is excluded from the hibernation and can not vote.

Excluded Debts

“Excluded debt” refers to debts “incurred” on or after the date the notice is delivered. This needs to be addressed as normal.

IRD

If the business is already paying an installment arrangement with IRD that debt is excluded from the hibernation and can not vote.

Legal Requirements of the First Notice

1

A signed certificate from each supporting board member, showing their agreement to enter business debt hibernation according to the Act (eg there is reason to believe creditors will accept your proposal and your business will be able to pay its debts as they are due)

2

At least a high-level description of your proposed arrangement

3

Total number of creditors and the total amount you owe

4

The postal or email address and telephone number for enquiries
The date you sent the Entry Notice to the Companies Office

When you have sent your Entry Notice to the Companies Office, you must also send a copy to each of your creditors, including:

This is not your creditor proposal but gives your creditors the initial information they need. If a board doesn't send this information each director has committed an offence and can receive a fine.

Advantages & Disadvantages

Advantages

A moratorium on the enforcement of debts once a proposal is notified to creditors for up to seven months

Voting threshold is lower than the alternatives - (50% by number and value)

GSA holders will be commercially sensible and most entities will need their support before getting a BDH proposal across the line

Disadvantages

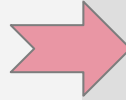
GSA not subject to moratorium

Precluding businesses that are already paying an IRD installment arrangement

Have to pay the debt back. So may have to use in conjunction with another procedure, such as a Part 14 Compromise.

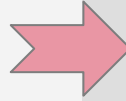
FAQ's [COVID-19 Business Debt Hibernation]

Do businesses need to apply to Government to go into Business Debt Hibernation?



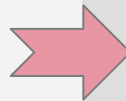
Yes but the first month moratorium is automatic. The business must submit a Business Debt Hibernation Entry Notice to the Registrar, which provides a one-month protection period while the business discusses its proposal with creditors. An extension of the moratorium is subject to creditor agreement.

Can any business go into Business Debt Hibernation?



Business Debt Hibernation is available to a wide range of businesses (including companies, trusts and partnerships) who were registered or existed prior to 3 April 2020. It does not include sole traders, insurers, banks and non-bank deposit takers.

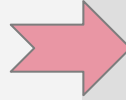
Can a transaction be unwound if the business in hibernation then liquidates afterwards?



Any further payments, or dispositions of property, made by the business to third party creditors are exempt from the voidable transactions regime during the protection period. This exemption is subject to the condition that the transaction was entered into in good faith by both parties, on arm's length terms and without the intent to deprive the existing creditors of the business.

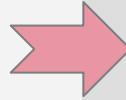
FAQ's [COVID-19 Business Debt Hibernation]

What if all creditors do not agree with the Business Debt Hibernation?



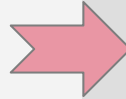
If the proposal has majority agreement, meaning 50% or more by number and value, all creditors are bound - not just those who voted for it. Creditors cannot enforce existing debt during the six-month standstill. Creditors can go to the court to seek relief in exceptional circumstances.

How are other secured creditors treated?



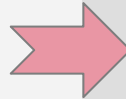
The same as other creditors. They are bound by the moratorium so can not enforce their security, but are entitled to vote.

Can businesses keep trading and incur new debt while in hibernation?



Yes, subject to any restrictions agreed with creditors as a condition of entering into it. Those new debts are not subject to the hibernation so must be paid in the ordinary course.

How long can a business be in Business Debt Hibernation?



Protections generally apply for 1 month and then an additional 6 months if the creditors approve the arrangement.

Contact

Craig Sanson

Executive Director, Auckland

Tel: +64 (0) 21 766 613

Email: craig.a.sanson@pwc.com

Marcus McMillan

Director, Wellington

Tel: +64 (0) 27 511 6608

Email: marcus.j.mcmillan@pwc.com