Solvency and COVID-19

Solvency considerations within the pandemic context

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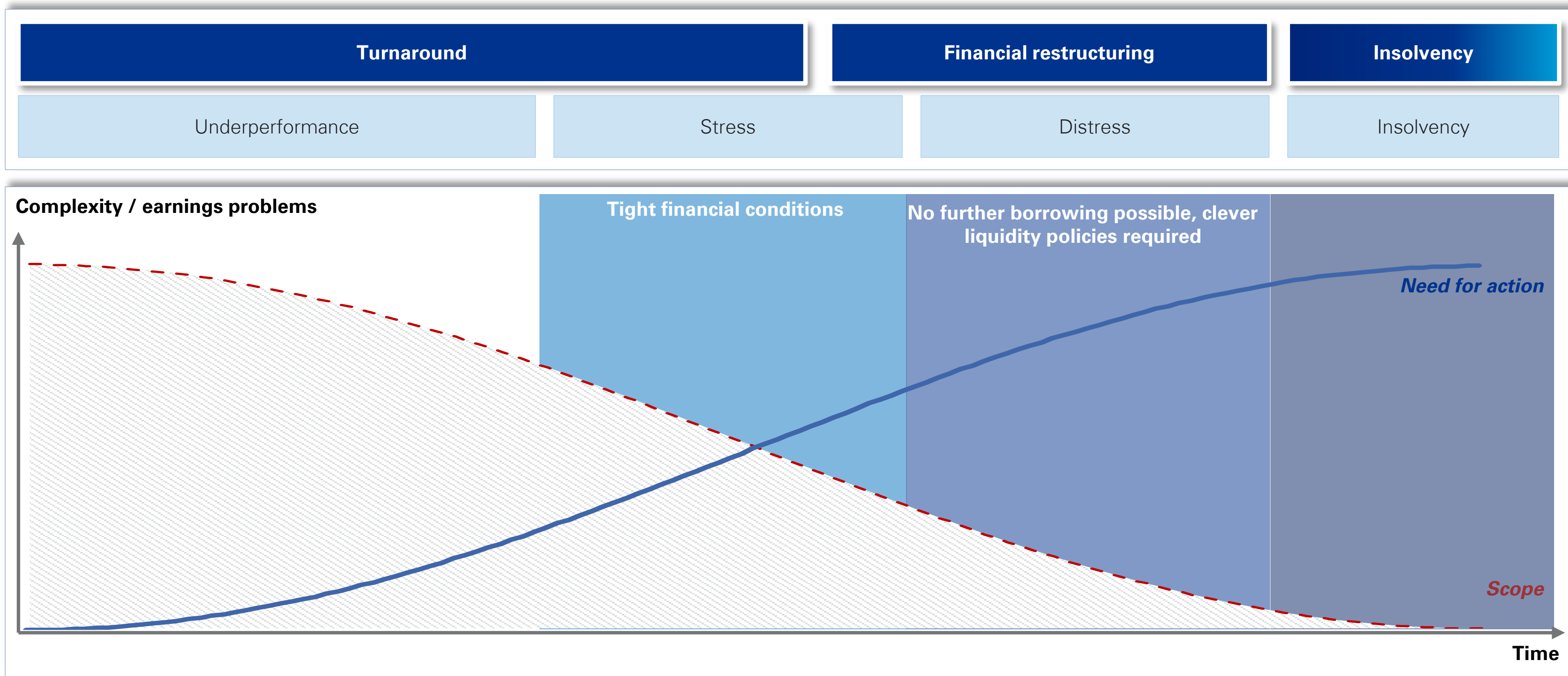
Introduction

Solvency issues have become a key consideration for many directors in the current trading environment given that COVID-19 is expected to have a greater adverse impact on the NZ economy than the 2008 global financial crisis and is unfortunately likely to trigger numerous business failures.

The national lockdowns have had a significant impact on certain businesses' trading and cashflow. In some instances, earnings have not yet returned and some businesses will be unlikely to recover. Directors will need to be mindful of the impact on the solvency of their business and carefully consider whether continuing to trade is in the best interests of the company and its creditors.

This paper provides practical guidance for directors that are considering issues of solvency. Optionality for stakeholders is likely to become more limited as the business comes under increasing financial stress. Acting earlier with some of the lighter actions may defer or lessen the requirements for more extreme measures further down the track. None of these choices are without consequences.



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Insolvency

Legal definition of solvency

Under the Companies Act 1993 (**Companies Act**) a company is solvent when:

- it is able to pay its debts as they become due in the normal course of business (known as **Cash Flow Solvent**); and
- the value of its assets is greater than the value of its liabilities (including contingent liabilities) (known as **Balance Sheet Solvent**).

Cash Flow Solvency

A company will typically be considered Cash Flow Solvent when its current expected cashflow and future receipts for a forecasted period are sufficient to pay its currently due/forecasted payments. In assessing whether a company is Cash Flow solvent consideration should be given to:

- whether the company is consistently in arrears with its creditors;
- whether the company's current receivables are likely to be recoverable;
- the likely level of future sales, taking into accounts the potential impact of any COVID-19 restrictions;
- whether there are any plans in place to address the cash flow deficiency and the feasibility of those plans (e.g. raising equity or debt to assist with cashflow);
- the likelihood of customers seeking refunds or relief from their obligations; and
- any upcoming debt amortisation or covenant testing requirements.

Balance Sheet Solvency

When assessing whether a company is Balance Sheet Solvent scrutiny needs to be given to whether the company's assets and liabilities represent market value and the true financial position of the company. In particular it should be considered:

- whether goodwill or other intangible assets have been tested for impairment and represents fair value at the time;
- whether related party receivables and shareholder loans are recoverable;
- whether there is a significant difference between the book value and market value of fixed assets; and
- the appropriate value of any contingent claims (i.e. claims for damages).

Indicators of insolvency

COVID-19 has put businesses under commercial pressures that may lead to solvency issues. Some other indicators that a company may be insolvent (or close to insolvent) are:

- defaulting on loan or banking facility covenants;
- an increase in overdue aged payables;
- a declining current ratio (current assets ÷ current liabilities) or a current ratio of less than 1;
- overdue tax liabilities and/or incurring associated interest and non-payment penalties on tax liabilities; and
- shifting debt from one place to another.

COVID-19 and solvency

The impact of the Government and consumer responses to COVID-19, in particular the various lockdowns, is likely to have put solvency pressure on companies in a number of ways:

- The company ceased to trade and receive revenue during the lockdown period while fixed costs continued to be incurred, resulting in a deterioration of cash reserves. In the event earnings have not returned to pre-COVID-19 levels, the business may now have difficulties paying its debts as they fall due (i.e. Cash Flow Insolvent);
- The company has become Balance Sheet Insolvent as its assets (cash reserves and receivables) were depleted in order to fund losses;
- The company has raised debt to fund its operating costs and losses and its balance sheet has deteriorated to the point that it has become Balance Sheet Insolvent.
- The company was owed money by a debtor(s) that has become unrecoverable due to the debtor not paying and/or entering an insolvency process, weakening both the balance sheet and cashflow of the company.

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Directors and insolvency

Implications for directors

Trading a company whilst it is insolvent places its creditors at serious risk. If the company fails, its creditors may go unpaid and may become insolvent themselves. Although directors may be optimistic about a company's future and want to carry on their business, there is a risk that they are placing other businesses at risk by incurring liabilities that they cannot pay. There is also a risk that they will be held personally liable for the company's debts for insolvent trading (a well documented example is *Mainzeal Property Construction Limited (in liq) & Ors v Yan & Ors*).

Liability for insolvent/reckless trading arises through directors' statutory duties under the Companies Act. The duties most relevant to insolvency scenarios are the duties to:

— act in good faith and in the best interests of the company;

— not allow the company to trade in a manner likely to create substantial risk of serious loss to the company's creditors (i.e. trade whilst insolvent);

— not incur an obligation unless they believe the company will be able to perform the obligation when required to do so; and

— exercise their powers/duties with the care, diligence and skill that a reasonable director would exercise in their circumstances.

The most common way these duties are breached (and a director becomes personally liable for company debts is where a director allows a company to trade while it is insolvent in circumstances where it would not be objectively reasonable to do so.

Although a company may be financially distressed and/or temporarily insolvent this does not necessarily mean a director will have immediately breached their duties to the company. What is required when a company enters troubled waters is for its directors to carry out a sober assessment as to the company's actual and prospective financial position and performance and the potential for remedying the insolvency. This assessment is not a one-off exercise and instead requires consistent and regular monitoring of whether the company is financially viable and:

— whether continuing to trade the company's business is in its best interests (and the interests of its creditors); and

— whether the company has the ability to trade out of its distressed position.

By constantly carrying out assessments of this nature directors can gain comfort that they are taking a legitimate business risk rather than breaching their duties under the Companies Act through reckless/insolvent trading.

If a company reaches the point where continued trading will result in a shortfall to creditors and the company is not salvageable, then continued trading will be in breach of the Act absent an agreement with creditors through a formal or informal restructuring process. Any directors that remain uncertain about compliance with their duties after considering the above factors should seek clarification from a suitably qualified legal and/or insolvency practitioner.

Safe harbour regime

The New Zealand Government temporarily amended the Companies Act to introduce a 'safe harbour' regime, a change that provided directors a degree of protection from insolvent trading claims.

The 'safe harbour' provided temporary protection for directors of business facing cashflow difficulties. The safe harbour operated between 3 April 2020 to 30 September 2020 (the **Safe Harbour Period**). New Zealand has not extended the Safe Harbour period and, unlike other jurisdictions, does not have a general Safe Harbour regime.

Accordingly, now that the safe harbour regime has ended, director duties relating to insolvent trading apply and, given the Supreme Court's recent decision in Debut Homes v Cooper, directors' obligations and risks have increased.

Debut Homes v Cooper[1]

A well documented judgment has been delivered by the Supreme Court in Debut Homes v Cooper which has arguably increased the standards expected of directors and provided further guidance on what directors should do when their company is insolvent. In summary:

— When a company is insolvent, there are informal and formal mechanisms available to address the solvency. While directors can utilise informal mechanisms, there must align with formal mechanisms.

— The Court confirmed that where there is no prospects of a company returning to solvency it makes no difference that a director honestly though some creditors would be better off by continuing to trade – and instead the director should consider formal insolvency mechanisms or informal options that may allow the company to return to solvency.

— If directors agree to debts being incurred (including non-contractual obligations such as GST) where they do not believe on reasonable grounds that the company will be able to perform the obligations when they fall due, then there will be a breach of the Act

— When facing insolvency, directors must consider the interests of all creditors;

— A director must not continue trading an insolvent business, on the basis that some creditors may be better off as a result, i.e. you cannot rob Peter to pay Paul.

[1] *Vivien Judith Madsen-Ries and Henry David Levin as Liquidators of Debut Homes Limited (in Liquidation) v Leonard Wayne Cooper* [2020] NZSC 100.

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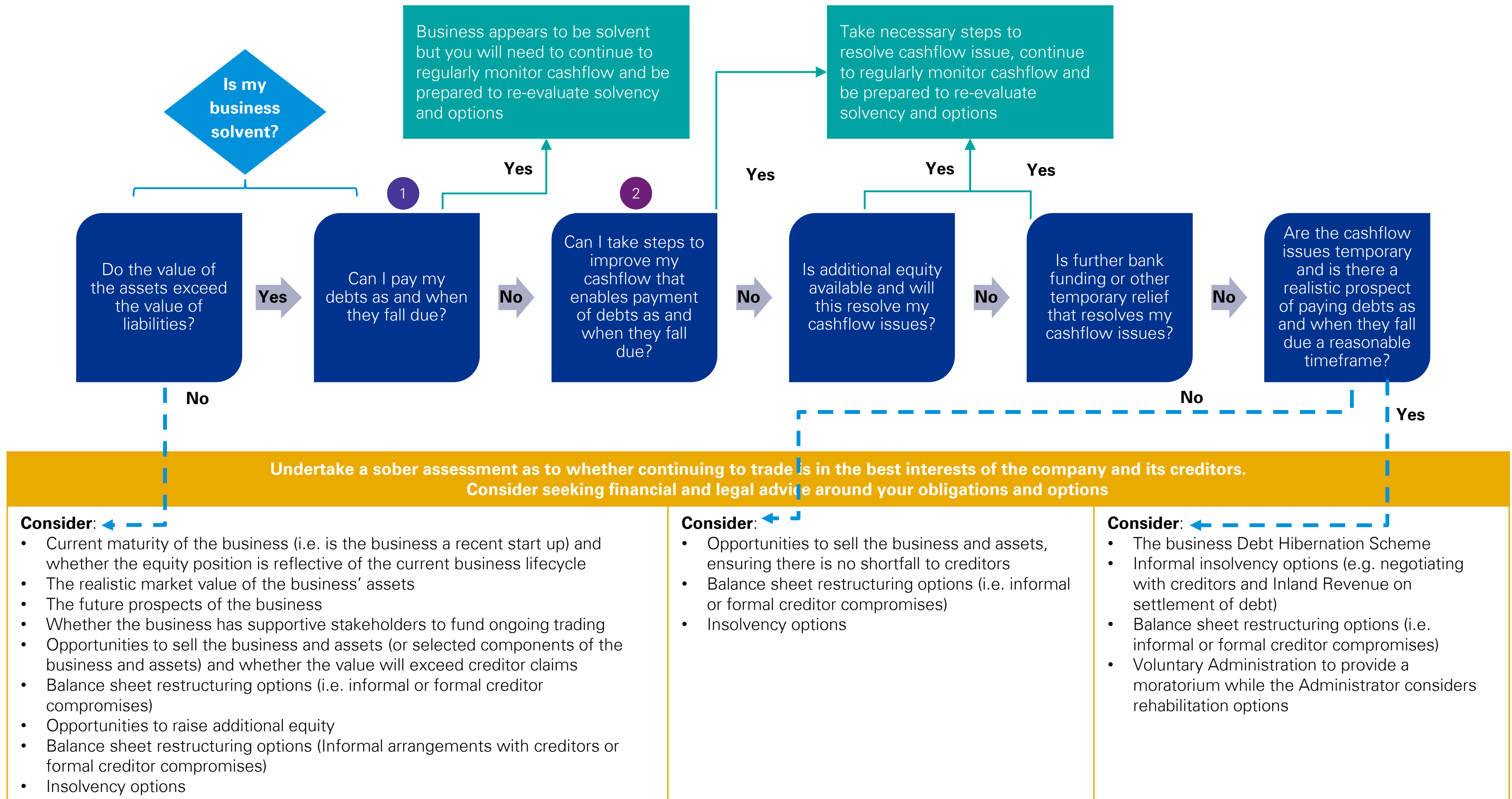
Solvency pathways

Summarised below is an indicative decision tree to assist stakeholders when considering next steps for a business facing cashflow solvency issues.



1. We recommend preparing a 17 week cash flow forecast to understand your short term position as well as a 12-18 month forecast to understand the mid-term impacts. The NZTE cash flow forecast tool is available to assist you with this process.
2. Consider the following mitigation strategies, prioritised in order: **No regrets:** Chase debtors, maximise existing payment terms; **Tactical:** Defer capex spend, renegotiate trade terms, remove or defer unnecessary costs; **Emergency:** Defer non-wage payments.

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Avoiding/mitigating insolvency

Focus points

When a company is distressed its board and management can potentially avoid/mitigate insolvency by:

- **Cut costs** – carry out a detailed review of your businesses expenditure and reduce any non-essential or discretionary costs.
- **Keep cash in your business longer** – pay your creditors on the day they are due (and not earlier) or look to improve trading terms to assist in alleviating cashflow timing pressures.
- **Consider your working capital requirements** – if additional working capital is required to assist with short term cashflow explore whether this can be achieved through asset divestment, debt factoring or raising equity/debt.
- **Engage with your bank as soon as possible** – manage your risk of the bank enforcing its security and discuss your short – mid term plan.
- **Engage and negotiate with creditors early** – consider and propose payment deferment/instalment arrangements to creditors and explain how this will benefit the creditor (e.g. that in a fire sale liquidation scenario they may receive much less).
- **Monitor debtors closely** – consider requiring cash on delivery if they are consistently late on payment and/or consider including a lien or specific security over your goods in your contractual terms.
- **Focus on liquidity and managing debts** – have both a short-term and long-term plan and forecast. Ensure that addressing the company's short term pressures does not result in it having no long term viability.

COVID-19

The COVID-19 scenario has put unique commercial pressures as well as unique options for relief for distressed companies. Companies can alleviate insolvency pressures by:

- **Assess your sector's exposure** – some sectors will take longer than others to recover or are unlikely to return to business as usual (e.g. international travel restrictions may stay in place putting tourism under prolonged pressure). Make sure to consider your sector's exposure and recovery lag time when assessing your business' future prospects.
- **Consider ceasing operations** – evaluate a scenario where you temporarily cease business operations and maintain a skeleton of your business, pending a return to a more normal trading environment (i.e. while border restrictions remain in place).
- **Engage with your bank and Inland Revenue** – Inland Revenue and the banks have publicly indicated they are open to relief discussions with affected businesses.
- **Discuss relief with your landlord** – you may be entitled to relief under your lease or your landlord may be able to pass on the benefits of their own mortgage holiday to you in the form of reduced rent. Subsidised arbitration and mediation is available for smaller tenants who haven't agreed lockdown abatements.
- **Review your contracts and insurance policies** – your contracts may have relief provisions and the COVID-19 scenario may be a covered event under your insurance policy.
- **Think long term** – although further debt may be available to support cashflow pressures, ensure you do not overleverage your business and that it can service this debt in a business.

Practical steps

Some practical steps that can be taken when facing financial distress are:

- **Board monitoring** – ensure the board meets regularly (at least weekly) to continually assess and evaluate the company's financial position and viability.
- **Document board decisions** – accurately record all board decisions as well as the reasons for those decisions and keep a record of any budget, forecast or other financial information relied upon.
- **Report and budget** – prepare and maintain up to date financial information (cashflow forecasts and budgets, balance sheet information).
- **Have controls on expenditure** – tighten controls on expenditure approval and maintain closer oversight on expenditure.
- **Communicate** – maintain open and transparent lines of communication as to the company's position with management, creditors and debtors.
- **Seek professional advice** – discuss your position with a corporate or insolvency lawyer to ensure you are not at risk of breaching your duties to the company and seek financial and strategic advice from a licensed insolvency practitioner. Specific advice relating to your situation may provide a defence in the event of an insolvent trading claim being made against you.

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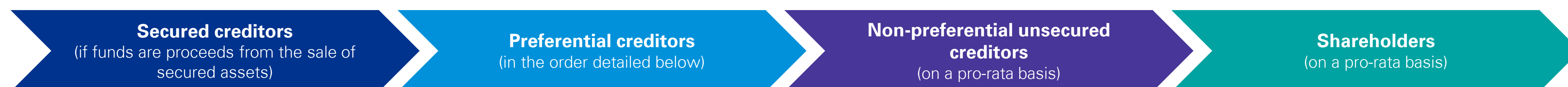
Distribution of assets and funds

Insolvency stakeholders

The Companies Act prescribes the order in which creditors and its shareholders are paid from the company's assets in an insolvency scenario, and in particular the priority of payment amongst different classes of creditors.

If you suspect your company is insolvent and are liquidating assets to pay debt, you will need to consider the relevant security interests and statutory priorities. Failing to do so may lead to a liquidator later having recourse against the recipient of funds, or you as a director. Similarly when receiving payment from a debtor you believe is distressed you should ensure you are receiving the payment in the correct priority and/or making an internal provision for these funds to be potentially clawed back in an insolvency (other than if the funds were received from a business using a business debt hibernation agreement).

Understanding how the "waterfall of funds" flow in an insolvency scenario is also important when preparing a compromise for your creditors. These priorities can be analysed so that you can show how much funds a particular class of creditor is likely to receive under a particular proposal vs in an insolvency scenario. This priority order is typically:



Secured creditors

Secured creditors have first priority to the proceeds from the sale of any assets their debt is secured against. There are three main types of security interests, these are those securing debt:

— by a general security agreement (**GSA**) over all present and after acquired personal property (e.g. a bank loan or overdraft facility);

— by a purchase money security interest (**PMSI**) which secures the debt against a specific asset that was purchased with the funds the secured creditor lent (or on credit) (e.g vehicle finance); or

— a specific security agreement over a specific asset (with the funds lent not being used to purchase that asset) (e.g. offering a piece of equipment as security for the debt).

Secured creditors will generally rank in priority amongst themselves by the earliest date they registered their security with the exceptions that:

— a GSA does not have priority to the company's accounts receivables and inventory (preferential creditors do); and

— a PMSI has super priority to the proceeds of the sale of its secured asset (even if a GSA was registered prior).

If all assets have been realised and secured debt remains then the remainder of a secured creditor's debt will rank as non-preferential unsecured.

Preferential creditors

Preferential creditors are the highest ranking unsecured creditors. Preferential creditors have five tiers of priority and should be paid in this order:

1. A liquidator and their fees (if any)
2. Employee entitlements (on a pro rata basis)
3. Layby sales (on a pro rata basis)
4. The costs of a compromise with creditors (if any)
5. GST, PAYE, NRWT, RWT and certain customs duties (on a pro rata basis)

Non-preferential unsecured

Non-preferential creditors are subordinate to preferential unsecured creditors. Non-preferential unsecured creditors rank equally amongst themselves on a pro-rata basis. Secured debt that exceeds the value of the security ranks as non-preferential unsecured debt.

Shareholders

After all a company's creditors have been paid in full any surplus assets are to be distributed in accordance with the company's constitution. If the company's constitution does not prescribe a method of distribution then the surplus should be distributed to the company's shareholders on a pro-rata basis.

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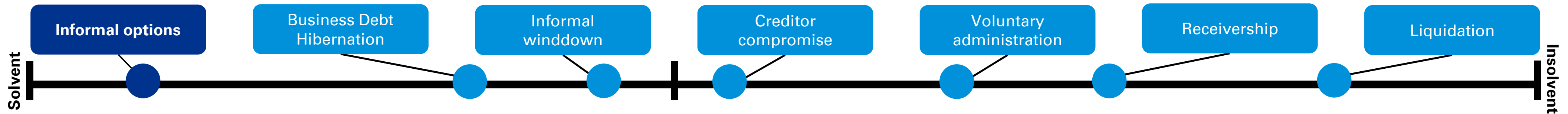
Informal options



When a company begins to enter troubled waters its directors should initially consider whether any informal options such as arrangements with creditors are available. When considering these options it is important that directors ensure the options align with their directors' duties under the Companies Act, and in particular the importance of the company maintaining or returning to solvency.

When is this the right process?	— When your company has a **moderate to strong balance sheet** but is suffering from **short term cash flow pressures**. — When your company is insolvent but **can return to solvency through informal restructuring options**. — There are **limited short term prospects** of trading returning to a breakeven level but long term prospects appear strong.
What do I need to do?	— **Identify your challenges** – determine what your company's solvency issues are, e.g. are you having difficulties remaining current with your landlord or a specific trade creditor? Having difficulty remaining current with provisional tax or GST? Is your company balance sheet solvent? — **Analyse how you can address your challenges** – what can your company afford to pay towards its creditors? Would establishing a payment plan alleviate cash flow issues? Would further lending facilities/an overdraft assist? Is shareholder financial support available? — **Formulate a proposal** – if putting forward a proposal to creditors, ensure that you approach all classes of creditors. Communicate the details of your proposal (e.g. to pay a % of all debts or make payment over time). Let the creditors know how this will impact them and what the alternatives are (e.g. a formal insolvency process). — **Document your decision making** – ensure you document your decision making and reasons for these decisions at a board level (including keeping records of any professional advice received). — **Continue to monitor** – continue to monitor your company's financial position on a regular basis.
What are the risks?	— **Ensure you treat creditors fairly** – do not prefer one creditor or class of creditor over others. If you are in doubt as to how creditors rank/should be treated then consult an appropriately qualified advisor. — **Obtain market value** – if disposing of assets or settling creditor debt with assets other than cash ensure that the transaction represents market value (or a later appointed liquidator may look to the recipient or yourself as a director for compensation). — **Act in good faith** – ensure you consider the interests of all creditors and decisions are not made subject to any bias or conflict.
How do I govern the process?	— **Directors should document their decisions** to temporarily cease trading and the reasons for that decision and forecasts relied upon (in board resolutions or minutes). — **Continue to monitor** cashflow and prospects of a recovery.
What is the likely outcome?	The ideal outcome of an informal process is that the company returns to solvency and/or reaches a position were it has a stronger balance sheet and capital structure than it otherwise would have had.

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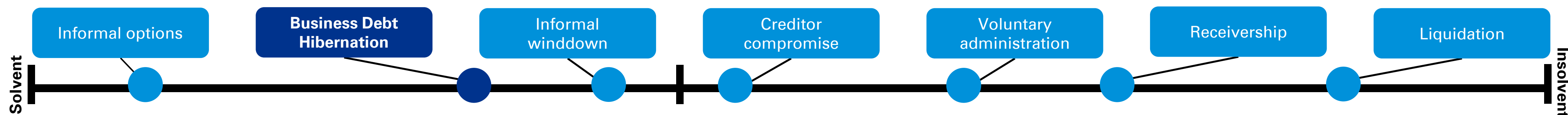
Business Debt Hibernation



The Government introduced legislation to create a 'business debt hibernation scheme' (**BDH Scheme** or **Scheme**) to provide temporary relief from the impacts of COVID-19. The BDH scheme is a formal process intended to be a simple, self-help regime for companies to place existing debts in hibernation and obtain the benefit of a moratorium through the hibernation process. The key features of the proposal are:

- it applies to companies, partnerships, trusts but not licensed insurers, registered banks, or non-bank deposit takers;
- directors must act in good faith in entering a BDH and confirm that the company was able to pay its debts as they became due as at 31 December 2019, is facing liquidity problems as a result of COVID-19 and it is more likely than not that the company will be able to pay its debts as they fall due on 30 September 2020;
- creditors will have a month from the date of notification of the proposal to vote on it, with the proposal going ahead if 50% (by number and value) agree;
- if the voting thresholds are met, it will be binding on all creditors (other than employees) and subject to any conditions agreed; and
- there will be a one month moratorium on the enforcement of debts from the date the proposal is notified, and a further 6 month moratorium if the proposal is passed.

At this stage the BDH Scheme is available to directors to enter into until 24 December 2020 (or later date as prescribed by regulation).

When is this the right process?	— When your company has a **distressed to moderate balance sheet** and is **suffering from short term cash flow issues**. — When your **creditors are likely to commence enforcement action** against you to recover their debt (or already have). — When you **need breathing space** to formulate a substantive restructuring plan.
What do I need to do?	— **Analyse the outcomes for your creditor** – what are your respective creditor classes likely to receive in an insolvency scenario? Will they be better off if you utilise the BDH Scheme while you formulate a substantive restructuring proposal (e.g. the sale of your business, a creditor compromise, or pre-packaged voluntary administration) or otherwise to allow the business to build up reserves from ongoing trading? — **Identify the creditors you need support from** – which creditors make up 50% in value of your total creditors and are likely to support a DBH Scheme proposal? Should you have informal discussions with them prior to putting forward a proposal? Which other creditors do you need support from to reach 50% in number? — **Plan out your communications strategy** – how will you reach out to the most important creditors prior to putting forward to a DBH Scheme proposal? How will you communicate to your creditors that they will be better off by approving the proposal? — **Issue a notice to creditors** – issue a notice of the BDH Scheme to creditors and decide on a mechanism through which they can vote (e.g. by creditor meeting). — **Plan your restructuring proposal** – review your company's prospects and consider whether you can achieve the sell down of non-essential assets yourself. Or, if you're considering a business sale and/or formal insolvency process speak with a legal advisor and/or insolvency practitioner.
What are the risks?	— **Act swiftly** – if you are facing creditor and cashflow pressure and consider that the BDH Scheme will allow you time to reorganise your affairs and improve your company's long term prospects, you should act quickly to preserve cash and optionality. — **Have a mid-term plan** – the BDH Scheme is not a plan of itself and only prevents creditors taking enforcement action against your company in the short term. Without a plan to restructure your business the Scheme is only delaying the inevitable.
How do I govern the process?	— **Pass a resolution** – for a company to enter the BDH Scheme at least 80% of its directors must vote in favor of a resolution for the entity to do so. — **Document your reasoning** – directors are also required to sign a certificate stating their reasoning for the company entering the Scheme and verifying why they consider it meets the Scheme's criteria.
What is the likely outcome?	A business is given either 1 or 6 months of breathing room to trade out of its position or formulate a substantive restructuring proposal.

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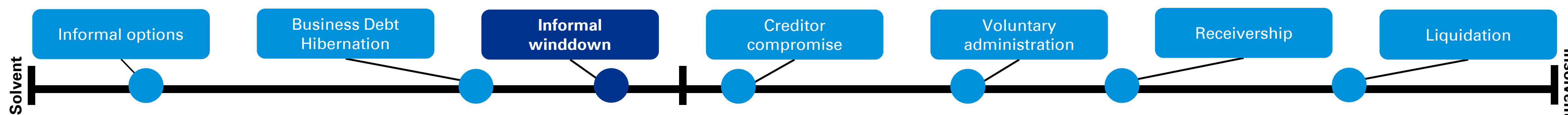
Informal winddown



If a company has poor future prospects, but is currently solvent and, some directors can initiate an informal winddown process provided this results in a full return to creditors. This would involve the sale of the company's assets and winddown in trading activity either in part or in full. Consider whether this is best managed by a liquidator rather than by the directors.

When is this the right process?	— When your company is **Balance Sheet Solvent** and is **suffering from cash flow issues**. — When your forecasts indicate that your company will **not be able to trade out of its current position**. — When you and/or your shareholders **want to exit your company** and realise any existing equity without going through a formal insolvency process**.** — When the informal process will lead to **full repayment of all creditors**. Continuing to trade a business, or managing a wind down, in situations where there will be a shortfall to creditors carries significant risks for directors and should be undertaken through a formal mechanism.

What do I need to do?	— **Seek professional advice –** to ensure you understand the risks with this process and that the process aligns with any formal mechanisms.
	— **Ensure the process aligns with formal mechanisms** – the directors must act consistently with their duties, the scheme of the Companies Act and the key features of the formal insolvency mechanisms available.
	— **Obtain market valuations for your assets** – ensure you obtain the appropriate valuation and liquidate the asset for as close to market value as possible. Transactions could be challenged later if market value is not received.
	— **Engage brokers to assist in the sale of your assets** – if you do not have a purchaser already lined up then engage the appropriate brokers (e.g. real estate, business, or auctioneer) to assist in the sale process. Using a broker also evidences that you ran a competitive sale process and obtained market value.
	— **Engage with your creditors and distribute funds** – communicate the proposed distribution plan with creditors and ensure you obtain their agreement to any restructuring of their debt.
	— **Pay your taxes** – ensure you pay any taxes incurred throughout the winddown process as tax arrears could result in Inland Revenue applying to liquidate your company later.
	— **Apply to have the company removed from the Companies Register** – after all funds have been distributed you can apply to have the company removed from the Registry on the basis that either:
	    — the company has discharged in full its liabilities to all known creditors and distributed its surplus assets; or
	    — the company has no surplus assets after paying its debts in full or in part and no creditor has applied to court for the liquidation of the company.

What are the risks?	— **Consider a formal insolvency process** – a formal insolvency process carried out by a professional does not carry the risk of you making an incorrect decision or distribution that may lead to claims being made against you personally. Any informal process must fully align with formal insolvency mechanisms. — **Be mindful of your duties to the company** - if the company is distressed it is important that directors act consistently with their duties under the Companies Act. — **Monitor and assess the prospective outcomes** – an informal wind down should only be used when there will be a full return to all creditors (unless agreements have been reached with creditors to receive a reduced amount). If at any time during the process it appears there will be a shortfall, you will need to seek professional advice and consider using formal and informal insolvency mechanisms. — **Make sure all creditors are paid in full** – if there is a shortfall to creditors claims may be made against the directors for breaching their duties.
How do I govern the process?	— **Document your decisions** – The decision to winddown a company's business in part of full should be accompanied by a board resolution and/or board minutes documenting the decision and reason for doing so.
What is the likely outcome?	The company could wind down non-essential operations and realise these assets or wind down its operations and realise its assets in totality. Ideally a partial winddown would result in the company's cashflow and/or balance sheet solvency improving along with its future prospects. A full winddown will result in all of the company's assets being liquidated and distributed to its creditors.

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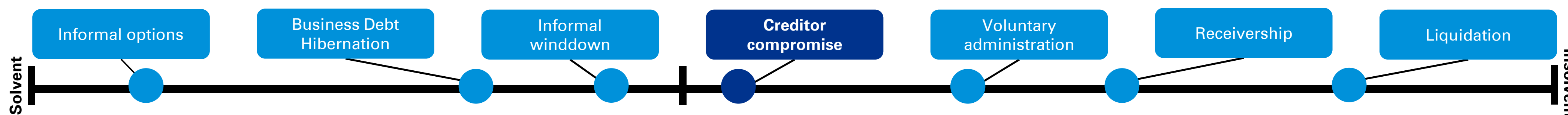
Creditor compromise



A creditor compromise is a formal process through which a company may enter into binding compromises with its creditors to cancel all or part of their debt or vary the terms of that debt.

When is this the right process?	— When **your company is insolvent** (either Cash Flow Insolvent or Balance Sheet Insolvent) **but could become solvent** (or trade its way to solvency) by deferring, devaluing or changing the terms of its debts. — When **majority of your creditors are likely to approve a compromise** (e.g. because they value your continued business or are likely to receive more value through a compromise than an insolvency process). — When you have a **large number of creditors and individual creditor negotiations are not feasible**, or otherwise a small number of creditors are unwilling to agree to terms that the rest of your creditors have consented to. — May be used **in conjunction with the BDH scheme** to provide a moratorium and to restructure the balance sheet.
What do I need to do?	— **Your company must be insolvent** – it is a prerequisite that your company is unable to pay its debts (or you have reason to believe it is unable to). — **Consider engaging a legal advisor/insolvency practitioner** – although neither are required it is recommended that you have an advisor guiding you through the process. — **Analyse your creditor profile** – how much will they receive in an insolvency (e.g. liquidation) if your assets are sold in a fire sale scenario? Are they likely to do better through a compromise and agree to the proposal? — **Formulate a proposal** – a compromise will most often propose to cancel all or part of creditor debts or vary the rights of creditors or the terms of debts. — **Have your board vote** – on putting forward a compromise proposal to the company's creditors. — **Draft and issue a notification of proposed compromise** – this notice must be in the form detailed at section 229 of the Companies Act and invite creditors to a meeting to vote on the proposal (with at least 5 working days notice of that meeting). — **Hold a creditors meeting** – have your creditors vote on the compromise at the creditor meeting (held in accordance with Schedule 5 of the Companies Act). A majority vote of 75% in value or in class of creditors is required to approve the compromise.
What happens next?	— If it is **approved,** the terms of the compromise are binding between the company and its creditors (even those that did not vote in favour of the compromise). — If it is **not approved,** the company has now declared its insolvency to its creditors and should consider an insolvency process such as a voluntary administration or liquidation immediately.
How do I govern the process?	— **The board leads the process** – the only party that can put forward a creditor compromise from the company's side is its board of directors. The board should ensure that the decision to propose a compromise and the reasons for doing so are well documented by a board resolution to put forward the compromise and board minutes.
What is the likely outcome?	— If a creditor compromise is approved the company is obligated to make payment to creditors in accordance with the terms of the compromise, and the creditors are bound from enforcement until there is further default. The compromise should ultimately reduce the liabilities on the company's balance sheet or its cash flow pressures and allow it to trade out of insolvency. — If the creditor compromise is not approved the board should consider an informal wind down and/or other formal insolvency processes.

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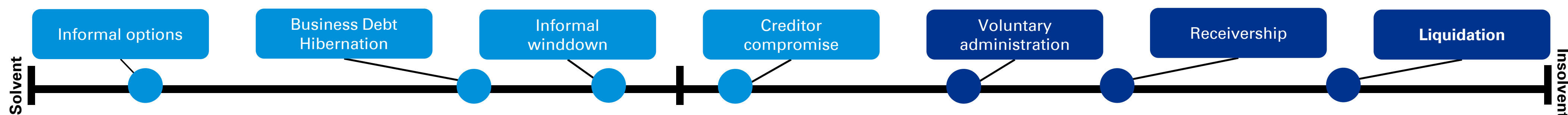
Formal insolvency options



	Voluntary administration	Receivership	Liquidation
What is it?	A voluntary administration (**VA**) is a formal process used for companies that have the potential to be rehabilitated (returned to a solvent position). The VA process is typically used where a company is insolvent (or will be shortly) but still has a business or other assets of value. A VA initiates a period where the affairs of the company are "frozen" which allows breathing space for an administrator to look to restructure the company's affairs, sell assets or compromise with creditors. During this period the company can continue to trade while exploring restructuring options that may be available to it.	A formal process whereby a secured creditor appoints a receiver to realise assets subject to their security interest. This process is almost always initiated by a GSA holder such as a bank.	A liquidation is a formal process used where companies have no prospect of being rehabilitated. An insolvent liquidation is the most destructive insolvency process to a business' value and is unlikely to return any value to shareholders. A liquidation is most commonly initiated by a company's shareholders, or by the court on the application of a creditor.
When is this the right process?	— When your company has a **business that has potential future prospects** but is insolvent (either Cash Flow Insolvent or Balance Sheet Insolvent) or is likely to become insolvent. — When your **creditors are likely to commence enforcement action** against you to recover their debt. — When your company **needs breathing space** to formulate/execute a substantive restructuring plan. — If you are **concerned you may be trading while insolvent** or otherwise breaching your duties as a director.	— If you have a **GSA over another company's assets** and they are in breach of their lending covenants you may be able to appoint a receiver over that company's assets. — Or, if **you are in breach of your lending covenants** with a creditor who holds a GSA over your assets and they insist on appointing a receiver over your company.	— When **your company is insolvent** (either Cash Flow Insolvent or Balance Sheet Insolvent) **or could become insolvent** very shortly (and there are not reasonable prospects of the company being able to trade its way out of insolvency). — If you are **concerned you may be insolvent trading** or otherwise breaching your duties as a director. — If **a creditor has applied to have your company placed into liquidation** and you would prefer to control the process and choose the liquidator (you have 10 working days to pass a shareholder resolution appointing your own liquidator after receiving a creditors application to liquidate your company).
What do I need to do?	Discuss your company's financial position with your legal advisor or a licensed insolvency practitioner.		
What is the likely outcome?	A VA will typically result in one of the following outcomes being achieved: — a binding compromise is reached with creditors which is documented by a "deed of company agreement" and control of the company is given back to its directors; or — the company is placed into liquidation.	A receivership will result in repayment of secured creditor debt to the extent that the company's assets can do so. The process is usually terminal to a company and it is unlikely that it will have a business or assets at the end of the receivership (depending on the extent of the security over its assets). It is common for a liquidation to coincide with a receivership.	A liquidation will result in all of the company's assets being realised and the company being removed from the Companies Register.

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Key contacts

If your business is facing solvency pressures, reach out to any of the contacts below for further information and guidance.

Contact	Description	Details
Official Assignee / Insolvency and Trustee Services (**MBIE**)	Public insolvency office that can take insolvency practitioner appointments. Primarily useful for smaller businesses.	0508 insolvency Insolvency.govt.nz
Restructuring, Insolvency and Turnaround Association New Zealand (**RITANZ**)	RITANZ is the professional body for insolvency practitioners and for those working in business reconstruction, turnaround and insolvency.	RITANZ.org.nz
New Zealand Trade and Enterprise (**NZTE**)	NZTE is the Government agency that helps New Zealand businesses grow internationally. NZTE's website contains a range of resources and guidance for businesses around managing cashflow issues and considering strategic options.	NZTE.govt.nz
Institute of Directors New Zealand (**IOD**)	The IOD is the professional body for directors and is at the heart of New Zealand's governance community. IOD's website provides a range of resources and guidance for directors.	IOD.org.nz

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