

## INSIDE:

Hollowed Debtors  
and the GSA

PG 2

Bankrupting  
the Dead

PG 2

Getting Off the  
Netting Off

PG 3

Crooks, Rogues and the  
Insolvency Profession

PG 5

Is Your Company  
Solvent?

PG 6

First 'Phoenix Offence'  
Company Prosecution

PG 7

Removing  
Liquidators

PG 8

The Overdrawn  
Current Account

PG 8



# Voluntary Administration falls flat

# Hollowed Debtors and the GSA

A GSA is designed to give a high level of security to a party advancing funds to a company. In reality the GSA often attaches to few assets of tangible value.

Looking at the main assets of an insolvent company:

## Physical Assets

(Vehicles, plant and machinery, etc.)

Most physical assets have a specific PPSR security. Where the company has borrowed money for the purpose of buying an asset, then that specific debt is secured over the asset in question. Only if the asset is sold for more than the value of the secured debt can the GSA holder lay claim to the surplus.

## Land

A registered mortgage ranks ahead of a GSA.

## Stock and Debtors

Section 312 of the Companies Act specifically excludes such assets as being available to the GSA holder. These assets must be realised and the money paid to the preferential creditors (staff and the IRD primarily) before being available to the GSA holder.

The GSA holder is left with unencumbered assets and in an insolvent company this can be reduced to the office furniture and maybe some obsolete computers. This places pressure on GSA holders to act quickly before their debt becomes impaired. We have seen a number of cases where GSA holders seek advice six to twelve months too late. What was once a business with some economic value has been hollowed out.

Often the main value of a businesses is the business itself. Sold as a going concern, or restructured, the business may have some

economic value. This is available to a GSA holder but can often involve the GSA holder pro-actively engaging with the debtor to attempt to work out a restructuring plan to get the business back trading.

Some GSA holders have engaged with the Voluntary Administration regime in order to try and wring some value from a debtor. In most cases this will not be an option because the company will not be salvageable. Thus the GSA holder is in a quandary. Act too quickly and destroy a company that could have repaid the debt, or wait too long and discover that the company has nothing of value.

We advise GSA holders to seek financial information from the debtor, especially if payment defaults start to occur. The best decision is an informed decision.

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## Bankrupting the Dead

The good citizens of England were in the habit of digging up the deceased (Oliver Cromwell being the most infamous example) and rendering punishments on the body of the deceased.

Death, it seems, is not the final chapter in the affairs of man.

Under New Zealand law it is not possible to bankrupt the deceased, but it is possible to achieve a similar outcome by use of Part Six of the Insolvency Act 2006.

Either a creditor of the deceased or the beneficiary of the deceased estate can bring the matter to the court and request that the court hand over the affairs of the deceased to an administrator. The court may appoint the Official Assignee, the Public Trust, or anyone else considered suitable by the court.

The court will require evidence that the estate is insolvent, and that the creditors will be better served by appointing an administrator.

This would normally be the case if there was a complex or large insolvent estate, where there was no will, or the executor was not one trusted by the creditors.

Before a creditor can bring a claim to the court they must be able to show to the court that they are in fact a creditor. A claim is

insufficient, there must be an undisputed debt that could be used to effect a bankruptcy. If the debt is disputed, then the issue must first be resolved by the court before the creditor can bring their application. The creditor must also show that the deceased estate is in fact insolvent.

The advantage under this section of the Insolvency Act is it is possible to get a creditor funded administrator over the affairs of the estate. The creditors would then have the choice of letting the estate be managed by the Official Assignee, Public Trust, or someone appointed by the petitioning creditor.

The Administrator has the same powers that the Official Assignee would have if the individual were bankrupt.

Interestingly, the legislature has put some thought into creating special classes of preferential creditors for in such a situation. Creditors are to be paid out in the following manner:

- Administrators costs
- Funeral expenses
- Last three months of medial costs.
- Preferential claims (ie; Staff claims, GST, PAYE, etc)
- Unsecured creditors.



# Getting Off the Netting Off

One of the liquidator's favourite pieces of legislation is Section 310 of the Companies Act.

Section 310 states that if someone owes money to a company in liquidation they cannot net-off any credits incurred within six months prior to the liquidation of the company.

So, if you provide accounting services to a furniture store and you recently purchased ten thousand dollars of furniture just before they went into liquidation then you have to pay that ten thousand dollars even though the company may owe you twenty thousand in accounting fees. (If the fees were incurred more than six months before the date of liquidation, or the date liquidation papers were lodged with the court for a court appointed liquidation, then you can net-off those invoices.)

Late last year there was an interesting case involving the 'Hard to Find but Worth the

Effort' book store and their unhappy landlord.

The Hard to Find bookstore owed their landlord \$45,000 in rent when they went into liquidation. The landlord, unimpressed at the state of affairs went into the bookstore and created \$90,000 of havoc, for which the liquidators, McDonald Vague, took them to court and won a judgement against.

The liquidators pursued the landlord for the \$90,000. The landlord responded by going back to court and claiming that they were entitled to net-off the outstanding rent.







The liquidators defended this action, confident that the six months no-net-off rule would protect them. The Wellington High Court, however, in an interesting twist decided that the breach did not happen when the bookstore failed to pay their rent, but rather when the lease was signed.

Because the lease was signed longer than six months before the date of liquidation the landlord was able to net-off the outstanding rent. Effectively, this judgement meant that the breach can be dated to the time that the contract was signed and not when the non-performance occurred.




This creates a perverse incentive to landlords with rent owing. Although the amendments to the Property Law Act in 2007 do not allow them to seize their tenants assets in the event of unpaid rent, if their tenant goes into liquidation then landlords have an effective immunity for at least the value of their unpaid rent. Distrain away!

EXISTING THEORY

Automotive work done by Jack's Motors (in Liq)	Accounting work done by Cindy's Books Ltd
 December 2011 Transmission on Cindy's Books company car, a Nissan Bluebird <b>\$1,500</b>	November 2011 <b>\$2,000</b> for end of year accounts for Jack's Motors 
<hr/> February 2012 WOF and service on Nissan Bluebird <b>\$400</b>	<hr/> <b>1st January 2012</b> <b>Last date creditors can net-off</b>
 May 2012 Broken handbrake repaired and two tyres changed <b>\$800</b>	1st March 2012 <b>\$1,800*</b> for IRD Tax Audit: advice and general work 
1st July 2012 Date of Voluntary Liquidation of Jack's Motors OR date liquidation action lodged with High Court	
<b>TOTAL: \$2,700</b> <u>\$2,700</u> <b>NET BALANCE: \$700</b>	<b>\$3,800</b> <u>(\$1,800*)</u> <u>\$2,000</u>

\*Cindy's Books Ltd cannot net-off the \$1,800 for the tax work done in March 2012 because it was within the 6 months the company went into liquidation. However, they can net off all invoices older than 6 months. Cindy's Books Ltd must pay Jack's Motors (in liquidation) \$700.

RECENT CASE

Money owed to Hard to Find Bookstore (in liq)	Money owed to Landlord
 February 2008 Landlord enters property causes <b>\$88,000</b> worth of damage. Liquidators win this in court.	May 2004 Lease signed 
<hr/> January 2008 <b>310 cut-off</b>	<hr/> <b>January 2008</b> <b>310 cut-off</b>
February 2008 Landlord enters property causes <b>\$88,000</b> worth of damage. Liquidators win this in court.	February 2008 <b>\$43,000</b> unpaid rent 
<b>EXPECTED RESULT</b> <b>TOTAL: \$88,000</b> <u>\$88,000</u> <b>NET BALANCE: \$88,000</b>	<b>\$43,000</b> <u>(\$43,000)</u> Not allowed to be net-off as unpaid rent in last 6 months <u>\$0.00</u>
<b>ACTUAL RESULT</b> <b>TOTAL: \$88,000</b> <u>\$88,000</u> <b>NET BALANCE: \$45,000</b>	<b>\$43,000</b> Judge finds breach dated from day lease signed, not when rent unpaid, therefore can net-off

# Waterstone

## IRD

# Voluntary Administration

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Back in 2008 Waterstone undertook the Voluntary Administration of a publisher, the Jones Group. This Administration has set two precedents.

The first was when, during the moratorium period of the Administration, a graphic design firm sought a High Court injunction to prevent the Administrators dealing with their design work. Maxim claimed ownership to the 'feel and vibe' of the magazines. The High Court in Auckland decided that, notwithstanding the merits or otherwise of this claim, legal action could not be taken against a firm in VA during the moratorium period.

The second precedent is of much greater significance.

To pass a DOCA under the New Zealand legislation 75% of the creditors by dollar value owed must support the proposal and, those creditors must represent over 50% by number of the total creditors. Only creditors who are included in the voting count towards the total.

The legislation states that the Administrators have a casting vote. Unhelpfully, exactly when the Administrators could use this vote was not specifically spelt out. Most commentators felt that, as the legislation was modelled closely on the Australian model, that the legislators intended that the casting vote to be used in New Zealand exactly as it was in Australia.

In Australia the threshold for a DOCA is only 50% by number of creditors and 50% by total debt. Further, Australian corporate law spells out unambiguously that a casting vote can be used by the Administrators when the creditors vote in favour of the DOCA by either number, or dollar value, but not both.

In the Jones vote a majority of creditors representing 68% by dollar value of total creditors supported the DOCA. Waterstone Administrators used their casting vote to pass the DOCA. Importantly, the DOCA did not grant any preference for the Inland Revenue for their preferential debt.

Quite rightly, the Inland Revenue elected to challenge our decision in the Auckland

High Court, and they were successful on both counts.

The Court found that in New Zealand an Administrator has a casting vote only when the value of creditors supporting the DOCA was over 75%, but that the number of creditors was tied.

The second critical issue was the issue of the Crown preference. Schedule Seven of the Companies Act specifies that the Inland Revenue has a preference for the payment of GST and PAYE in the event of a liquidation of a company. However, in the Voluntary Administration regime no such explicit mention is made towards Schedule Seven.

There is no such taxation preference in Australia but other preference exists, namely for outstanding wages for employees. DOCA's that have failed to take account of this preference in Australia have failed before the courts where a Voluntary Administration has been used as an alternative to a liquidation. However, where DOCA's have been a genuine restructuring the courts have decided that there was no

preference where there was no absolute end to the business or company.

In the Jones case the court found that even if the Administrators had been successful on the casting vote issue, the DOCA would have been terminated on the grounds as being oppressive to the Inland Revenue for displacing their preference and the judgement seemed to imply that any DOCA that failed to take account of the Revenue's preference would meet a similar judicial fate.

Voluntary Administration has failed to live up to its promise in New Zealand. Merely 78 companies have entered the regime and only 18 completed DOCA's have been signed.

This recent judgement means that there is very little difference between the Part 14 Compromise with Creditors and Voluntary Administration save for a six week moratorium and the personal liability of the Administrators.

The matter is being referred to the Court of Appeal.



# Crooks, Rogues and the Insolvency Profession



There is a new insolvency bill before parliament. It includes a provision for negative licensing.

Negative licensing is an interesting and apparently New Zealand specific term. It means that the Companies Office can ban people from being liquidators, as opposed to vetting them before they take appointments.

The thinking is that running a registration system is too costly. Much cheaper to simply issue an order preventing some individuals from taking appointments after they have raided the cookie jar.

Some commentators lament the lack of a regulated insolvency industry in New Zealand. In order to practice in New Zealand the main requirements are that you be over eighteen, not have had any recent dealings with the company and not be currently bankrupt or under the control of the Mental Health Act.

Some more restrictions are being introduced in the new insolvency bill but the main change is the right of the Companies

Office to ban individuals from taking insolvency appointments.

Without commenting on the merits of our light handed regime, it is important to point out that the number of individuals practicing insolvency in New Zealand is very small, perhaps around fifty people take appointments on a regular basis and make a living by doing so. Very few if any of these are likely to fall foul of the Companies Office but we will all be very aware of the consequences to our businesses of receiving such an order. There is a very small number of individuals who take appointments who should not do so, and they take a tiny fraction of the total insolvencies.

A properly regulated regime, such as operates in Australia, certainly does have its advocates but to those who believe it is a panacea only need to enter the name Stuart Ariff into Google. Mr Ariff is a colourful NSW identity, in the long tradition of colourful NSW identities, who used his position as a licensed insolvency practitioner to enrich himself (so it has been alleged) at the expense of the firms that were placed in his care. A Senate inquiry running in Australia

has received a large number of submissions from those who feel aggrieved by the actions of licensed insolvency practitioners.

A similar inquiry in New Zealand would no doubt reveal a similar level of complaints, some valid, many frankly not. The trade off by having a regime that makes it easy to practice as an insolvency practitioner in New Zealand is the ease with which the Companies Office will be able to remove those who fall below the standard deemed acceptable.

The primary allegation is that of excessive fees, allegations that are endemic to the practice of insolvency but not one that bears closer examination in New Zealand. A recent NBR article revealed that PriceWaterhouseCoopers had charged just over three million for their work on the Bridgecorp receivership, the largest of the finance company collapses. Considering that this file has been active for three years and total fees to date total less than half what Paul Reynolds earns in a year, it is easy to see that no one, sadly, is going to get rich practicing insolvency in New Zealand.

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## “But I own it”

Imagine this.

You are in the business of supplying surfboards. Cool business to be in and you have a fine new range of surf boards made in Bali you want to get to market.

You take your collection of surf boards to a local retailer and let him take ten on consignment. If the retailer sells them he will pay you. If he does not, you can go back to the store and collect your surf boards, maybe move them to a new store.

Now, a few weeks later the store goes into receivership. Shame, you think, but no problem, you simply go to the store to talk to the friendly receiver and ask for your surf boards back.

What happens next?

Despite the fact that the PPSR is ten years old, many New Zealand company directors will tell you that they would be able to collect the surf boards. After all, they belong to the surf board guy, and not the retailer.

And they are wrong. The receiver will sell the surf boards and give the money to the General Security Holder, or GSA (a debenture in the old terminology), who placed the company into receivership. Typically this will be the bank. If the company is in liquidation, and someone has a GSA, the liquidator will also keep the surf boards.

Put simply, if you lease or supply goods to a company and you do not register the fact that they are your goods on the PPSR ([www.ppsr.govt.nz](http://www.ppsr.govt.nz)) then you will most likely lose your goods if that company fails.

There is no space here to spell out why this is the case but too few company directors know this. The PPSR is a boring topic. Merely putting words PPSR anywhere in the body of a text guarantees people will not read it, which is proving to be great business for those who know what it is and how it works.

Usually the company director will find out the importance of the PPSR when an insolvency practitioner tells them that they have

lost their asset, and it is a conversation those of us working in insolvency have most weeks.

If your business sells goods, leases goods, or provides consignment stock and you do not know what the PPSR is then you should hang your head in shame. There is no excuse for not being informed about this regime and if you are not using it then you may as well leave your assets out on the street and hope for the best.

The PPSR is like safe sex. Inconvenient and a little dull but something you may come to wish dearly you had practiced if things go wrong.

If this has made you a little worried, talk to your accountant about the PPSR, and to your doctor if pain persists.



# Is Your Company Solvent? Risks for Directors and their Accountants

By Steven Khov



We often ask directors about their company's solvency. When asked if their company is solvent "I think so" is a common answer.

A company is usually deemed to be solvent if the assets are greater than liabilities but there are two tests a company must pass to be considered solvent: The 'balance sheet' test and the 'liquidity' test.

Section 4 of the Companies Act 1993 sets out the meaning of the solvency test. A company is solvent if both of the following are satisfied:

- The company is able to pay its debts as they become due in the normal course of business (The liquidity test); and
- The value of the company's assets is greater than the value of its liabilities, including contingent liabilities. (The balance sheet test)

It is common for directors to assume their company is solvent by satisfying the balance sheet test alone but when asked if they can pay their current bills the answer is often "no". A company is not required to meet the solvency test on a day to day basis as it is not uncommon for companies

to trade in and out of solvency as they operate but there are times when passing the solvency is required, including:

- Dividend distribution
- Repurchase or redemption of shares
- A reduction of shareholder liability
- Purchase of a major asset

The director(s) will need to sign a solvency certificate to confirm that the company will be solvent immediately after the proposed transaction has happened.

Knowing whether their company is solvent should be a part of good management for a director. There are implications for directors if their company is trading whilst insolvent. The common one is reckless trading.

The perception in the market place is that reckless trading prosecutions are rare, and they are, but what is not rare are settlement agreements between directors and their company's liquidators when directors have run their affairs recklessly.

Also looming as an increasing risk for accounting firms is imprudent advice given by accountants to their clients regarding the solvency of their business. The most com-

mon mistake accountants make is to advise their clients to take drawings rather than income, to reduce the cash drain of PAYE on an unprofitable business. At the time this can seem a prudent accounting decision but opens the accountant to a claim by the director if they are later forced to repay their current account.

There are many definitions of solvency and even though a company may trade in and out of solvency day to day, it is important to consider where the line is drawn. Recent case law determines whether the risk the director took is a 'legitimate business risk'. The 'South Pacific Shipping' case is a good guideline to determine the above. It is also important to note that a non-active or sleeping director may also be held responsible, as in the case of *Lewis v Meltzer*.

A quick test of solvency is available by completing our worksheet, available at [www.waterstone.co.nz/downloads/Solvency\\_Test.pdf](http://www.waterstone.co.nz/downloads/Solvency_Test.pdf)

If you would like to discuss any solvency issues, please feel free to contact Steven Khov – [steven@waterstone.co.nz](mailto:steven@waterstone.co.nz)

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## It is a Matter of Trust

Legend (okay, Wikipedia) has it that the history of trusts in English common law can be traced back to the crusades, where Knights who were off freeing the Levant from the Muslim hordes left their estates in the hands of trusted relatives or other faithful custodians. When the Knight returned, often these individuals turned out to be not so trust-worthy or faithful, and the Knights had to petition the King in order to establish that their lands had been held 'in trust'.

Today, of course, trusts are contrivances used for all manner of complex reasons, and the most complex is the 'trading trust'. I am unsure who can claim the credit for this idea but the concept is reasonably simple.

A trust is not a legal entity in itself. A trust is where an asset is held by someone for the benefit of someone else. If you give \$100,000 to your lawyer to pay for your child's education this money does not belong to your lawyer. He will not declare it as income. It is held 'in trust'. The same is

true with the family home being held in trust for the benefit of young children (and not to defeat creditors of Mum and Dad should they be sued and made bankrupt!).

Because a trust is not a legal entity there must be a trustee who holds the assets in their name. Usually this is a person but it does not have to be. It can also be an incorporated society, a limited liability company or even a law firm.

A trust can do more than just hold assets, it can actively trade. Some business people do just this, running their businesses as 'trading trusts' rather than limited liability companies. Rather than being the trustees themselves and risk personal liability for the trusts' debts, they make companies act as the trustees. They do this for two reasons. The first is that the Companies Act has consequences for company directors who act recklessly and the second is that the debts of the trading trust are legally incurred by a limited liability company. The brilliance of

this idea is that if the trust cannot pay its debts, then the trustee company becomes liable. The trading trust can simply fire the old trustee company and appoint a new one, leaving creditors chasing a shell company. Whilst there are remedies available to a determined creditor the cost is usually prohibitive.

There is virtually no valid reason for a business to be run as a trading trust. They should be treated with the same caution as Nigerian princelings seeking help liberating their uncle's money. The primary reason business people do this is to structure their affairs to limit their own exposure at the expense of their creditors. If you trade with such an entity, that creditor is you.

As a matter of policy a growing number of businesses in New Zealand are refusing to do business with trading trusts or demand personal guarantees from those involved if they do so, and this is a prudent business practice.

# First 'Phoenix Offence' Company Prosecution

## The NEU gets active

The National Enforcement Unit is a division of the Companies Office with the responsibility for enforcing some of the provisions of the Companies Act and they have been becoming more active in recent times.

One new area for the NEU is the Phoenix Company provisions of the Companies Act. This prevents company directors whose firms have failed from operating new businesses with the same or similar names.

The first person to be prosecuted for this was a Michael Donovan down in the sunny Hawkes Bay. He was the director of a business called Site It Limited, an engineering firm that was placed into liquidation owing an unspecified amount of money (the liquidators report was a bit thin) on the 1st of December 2008. Ever quick to get back on his feet Mr Donovan registered Site It Engineering Limited on the 2nd of December 2008 with a Patricia Donovan as the director.

This was not enough to protect Mr Donovan from the eagle eyes of the NEU who clearly held that Mr Donovan was in fact the person running the company and Mr Donovan was duly convicted of a breach of Section 386(a) of the Companies Act.

He was also discharged. Given that this was the first conviction for this offense, and the penalties under section 373(4) was a fine of up to \$50,000 and a prison term of up to five years this must be seen as a disappointing result. However, as a result of this conviction, Section 382 of the Companies Act automatically applies, so Mr Donovan is prohibited from being...

*"...a director or promoter of, or in any way, whether directly or indirectly, be concerned or take part in the management of, a com-*

*pany, unless that person first obtains the leave of the Court which may be given on such terms and conditions as the Court thinks fit."*

There are several more cases either before the courts or soon to be. With luck the NEU may be able to get some more deterrent value in their next convictions.

## What is it with Michael Donovan's?

In researching the above article regarding the fate of Mr Michael Paul Donovan of the Hawke's Bay and his Phoenix company, another Michael Donovan came to light. This one is Michael Philip Donovan of Tauranga, and this story is simply too entertaining not to be reported.

The second Mr Donovan was a director of For Finance Limited that owed the Inland Revenue \$36,000. In attempting to resolve this issue Mr Donovan sent the IRD a letter, advising them that he was sending them \$1.00 (which he did by taping a one dollar coin to his letter), and that if he did not hear back from the Commissioner then Mr Donovan would consider the little matter of his firms tax obligations completed.

It seems someone in the tax office receipted the dollar but no one bothered to inform this Mr Donovan that his one dollar was not considered as full and final settlement. In fact, a statutory demand was issued for the \$36,000.

In response, For Finance Limited elected to go to court to overturn the statutory demand, under the provisions of section 290 of the Companies Act, claiming that the payment of \$1.00 constituted settlement of the firms obligations to the IRD.

I am unsure what is the more remarkable, that For Finance decided to challenge the

statutory demand or that they were able to find a lawyer to face this before the Tauranga High Court. Either way, this matter did come before a Judge and from reading his judgement and his indication to the applicants lawyer that he was *"..mindful to take robust actions in dealing with the application of her client,"* the Judge was grumpy. It is perhaps not surprising that the lawyer sought leave half way through the brief hearing to abandon her client, and such leave was given.

The court also dismissed the application to set aside the statutory demand and put the company into the next available liquidation call.

The judge did, however, give consideration to Mr Donovan's position. He considered that the payment of taxes was not a contractual obligation and therefore not something that could be contracted out of, at least not in the way Mr Donovan attempted to.



*Our mascot Prudence, feeling the heat in Dubai.*

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# Removing Liquidators

Most people working in the New Zealand insolvency industry are honest hard working professionals. Insolvency is not a lucrative profession, unlike our regulated friends in Australia and very few enter the industry to get rich, and those few who do leave pretty smartly.

However, there can be times when a creditor finds themselves confronted with a liquidator who they would rather not be dealing with. Sometimes this can simply be because the creditor has a long established relationship with another insolvency firm, or that they simply wish a liquidator not appointed by the debtor company.

There are three strategies that can be employed in replacing a liquidator.

## **Court Appointed:**

If a liquidator has been appointed by the Court, usually at the bequest of the petitioning creditor, any creditor can call a creditors meeting. At this meeting the creditors can vote to remove the liquidator and replace them with someone of their choosing.

If the liquidator was appointed by the Court, however, only the Court can replace the liquidator. The outgoing liquidator must make the application to the Court to convey the wishes of the creditors to the Court.

The Court is not obligated to follow the wishes of the creditors, and can leave the current liquidator in office or put in office an entirely new liquidator.

The Court may over-ride the wishes of the creditors if the Court feels that parties related to the debtor company were instrumental in the vote, but in most cases the wishes of the creditors can be expected to be upheld.

## **Voluntary Appointments:**

If the liquidator was appointed by the shareholders, the liquidator is obligated to hold a creditors meeting if a creditor requests one (but the creditor must ask within ten working days of receiving notice that the liquidator does not intend to hold a creditors meeting.)

This creditors meeting must be held within ten working days of the request being made, and the meeting must be advertised in the New Zealand Gazette and the local newspaper, and it is now a legislative requirement that liquidators provide a list of all known creditors with their first liquidators report, which should help facilitate creditors getting in touch with each other.

At the creditors meeting a vote can be called to replace the liquidator. This vote must be passed with both 50% by number of

creditors voting and 50% of total creditors' debt. It is typically difficult to get this level of support to change a liquidator, especially if the company's staff back the incumbent, or where parties friendly to the shareholders are also creditors in the liquidation.

If the vote to change the liquidator fails due to the opposition of parties friendly to the debtor, then the creditors can make an application to the Court to have the issue determined by a High Court judge. The judiciary is empowered to grant an order overturning the vote if parties related to the shareholder have affected the outcome.

## **Voluntary: Section 241AA:**

Once legal liquidation proceedings have commenced against a company, the company has ten days to appoint their own liquidator or voluntary administrator once they have been served. Once they fall outside those ten days, any appointment will be considered invalid.

If the debtor company places themselves into liquidation within the ten days, then the petitioning creditor has a Plan B. They will have been given a court date for the liquidation of the company. Despite the fact that the company has been placed in liquidation, the creditor can ask the Court to replace the liquidator with one selected by the creditor.

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# The Overdrawn Current Account

A common and clever cash saving trick employed by many directors when they are facing cash issues is to stop taking a salary and record the money they take from the company as drawings.

This idea is sometimes not the director's but rather that of their external accountant. Either way, the effect is the same. If the company is making a loss, taking drawings instead of a salary is a good idea because it reduces the amount of PAYE that the company has to pay to the IRD.

If the company was making a profit this would have minimal cash effect because the company could expense the director's salary and reduce the corporate tax, drawings are considered a loan to the company director and therefore not an expense.

Alas, not all companies experiencing cash pressure come out the other side. Some end in the hands of a liquidator and one of

the first things liquidators do is look at the director's current account.

If you thought that was the end of the story you would be mistaken. A company director taking drawings must incur a liability to the company, to be repaid if the company demands it? Surely. Sadly not.

When confronted, delinquent company directors have rushed to the Court claiming a quantum meruit defence. The director concedes that they took drawings and not a salary, but they claim they did work for the company so therefore they were entitled to a salary and the company cannot have the money back.

This elaborate piece of sophistry has been upheld by the Courts. The leading case on this issue is *Shadbolt v Creative Concrete and Landscaping Limited*.

However, directors who run this defence

need to be wary. Income is income. A tetchy liquidator who has been stymied in this way may elect to inform the Inland Revenue of the matter, and would be correct in doing so. A current account that has gone unpaid can be viewed by the Inland Revenue as income and tax should be paid on it.

