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waterstone INSOLVENCY

EDITION 4

INSIDE:

Facing bankruptcy: Maybe it is time to re-look at the options

We look at Personal Compromise; Part 5 of the Insolvency Act 2006

Receivership vs. Liquidation

By Steven Khov

The terms are often used interchangeably, but they are quite different regimes.

In both cases external management is brought into the company to manage the business. From an external view point it is hard to tell the difference between a receivership and a liquidation. Indeed the processes share a lot of similarity, but there are some important differences as well.

Receivership

Receiverships are covered by the Receiverships Act 1993 but they have been developed over time through contract and developments in Common Law.

Historically, a debtor would grant the creditor the right to seize all of the debtor's assets if the debtor defaulted on their loan agreement. Debtors have thus been referred to as Grantors. In modern language, the term grantor has been dropped, as has the term debenture, being replaced by a General Security Agreement, or simply GSA.

The GSA governs the rights under which the creditor can appoint a receiver, and also governs the rights the receiver has once appointed.

Typically there are two documents:
A loan agreement, and a GSA that governs the creditor's rights in the event a loan agreement is breached.

For a receivership to occur, three things are needed:

- The debtor company must agree in writing that the creditor can appoint a receiver if the company does not pay its bills.
- The debtor company must actually become in breach of the agreement.
- The GSA holder then exercises their rights and appoints a receiver.

Once the receiver has completed their task, they can resign from the receivership.

Liquidation

Liquidations are a purely legislative creation. They are governed in New Zealand by part 16 of the Companies Act 1993 as amended.

Liquidations can occur in three ways: by the shareholders, by the courts or through a Voluntary Administration process.

A liquidator steps in to run the affairs of the business in much the same way a receiver does, but a liquidator has a number of powers conferred on him by statute that a receiver does not have.

A liquidator does not typically resign without appointing a replacement liquidator. A liquidation usually ends with the liquidator having the company struck off.

A receiver has a primary duty to and acts in the interest of the GSA holder; the party that has appointed him/her. A liquidator however, must act in the best interests of all creditors, unsecured, secured and preferential. However, a receiver has a duty of care to the other creditors of the company by not acting in a negligent manner.

Put simply, a receiver, appointed by a secured creditor, is working for his client, and not all creditors. The receiver has limited powers and these are primarily around the managing of the company's assets.

A liquidator, appointed by the shareholders or the court, is working for all creditors and has a wide array of powers to investigate the affairs of the company.

Distribution of money back to Creditors

In both a receivership and a liquidation the rules for paying money back to creditors are identical and are governed by Schedule Seven.

Getting into Receivership

The majority of loans are for a set period, with regular scheduled repayments. If the debtor meets the terms of the loan, then the GSA holder has no rights to put the company into receivership.

Typically the loan contract will have two key terms in it:

1) In the event of a default, the creditor can demand the entire loan be repaid. This changes the loan from a fixed term loan to an "on demand" loan.

2) In the event of a negative event, including a statutory demand being issued, an attempt to enter into a compromise with creditors, liquidation proceedings commencing, etc, then the loan can be considered 'at risk', and the creditor can consider this to be a default, even though the loan repayments may be up to date.

Once a loan becomes 'on demand', the debtor must repay it when demanded. They do not have the time to seek new finance arrangements.

As was once said from the bench:

"A debtor who is required to pay money on demand must have it ready, and is not entitled to further time in order to look for it."

Appointment of a Receiver

The appointment of a receiver has immediate effect and the receiver has the powers to run the company including hiring and firing staff, managing property, selling assets and entering into contracts.

The obligation to prove that the debtor is in default lies with the GSA holder and if the receiver is found to be improperly appointed the GSA holder can potentially be liable for substantial damages.

Receivership is a powerful tool available to creditors that is not often used. Most importantly, it allows the GSA holder to gain control of a company's assets promptly without having to go through the Courts. One could easily argue that this process protects the value of the assets as there may be little or no value left in the assets if a liquidation process was adopted.

Steven Khov is a liquidator at Waterstone Insolvency.

	Liquidator	Receiver
Appointed by	*Shareholders or Court*	*Secured creditor*
Agent of the company	*Yes, always*	*Yes, if no liquidator present*
Works for:	*All creditors*	*Creditor who appoints; duty of care to all creditors*
Creditors meeting	*Yes, if a creditor requests one*	*No*
Can void transactions	*Yes*	*No*
Can interview directors, shareholders etc under oath	*Yes*	*No*
Can sue directors for current accounts	*Yes*	*Yes, if no liquidator present*
Can sue directors for reckless trading	*Yes*	*No*

Statutory Demand. What is it really?

By Rebecca Hindwood

"A Statutory Demand is not to be used for debt collection purposes."

Why exactly this is the case no one seems entirely sure, but a statutory demand, (commonly called a stat demand) also called a 289 notice, is used for only one purpose, collecting debt, and a mighty useful tool it is for just that.

Description:

A statutory demand is a legal demand issued against a company, demanding that the company pay a debt due within fifteen working days.

Governing legislation:

Section 289 of the Companies Act 1993 covers the issuing of the demand. Section 290 covers the challenging of the demand.

The process:

Once a demand is issued, the debtor has ten working days to go to Court to challenge the demand, or fifteen working days to pay. If they do not do so, on day sixteen the creditor can go to Court to seek an order to place the company in liquidation.

Place of issue:

The demand can be served at the company's registered office, the regular place of business, or to a director. The demand cannot be served by fax, email or such. It must be physically served.

The debt:

The debt must be greater than $1000 and cannot be the subject of a dispute.

There are three common issues that arise from the issuing from a statutory demand:

Our mascot Prudence, admiring the roman ruins, in Leptis Magna, Libya.

1) The Challenge:

Once issued, a statutory demand, left unchallenged for ten working days, becomes proof of the company's insolvency and this evidence, presented before a judge, can be used to liquidate the company. It is important then, for companies who receive a statutory demand to either settle with the creditor or to challenge the demand in Court.

To challenge in Court they must lodge a statement of defence with the High Court, covered under Section 290 of the Act. To succeed they must show that either the debt is disputed, or that the company has some counterclaim against the creditor.

If they are successful the petitioning creditor will usually incur substantial costs awarded against them.

2) The Dispute:

There is a lot of case law on what constitutes a dispute. However, the debtor simply asserting a dispute will not suffice. The debtor must bring evidence to Court that the dispute is genuine and substantial. Further, if the dispute is over only part of the demand, then the debtor must pay the undisputed portion, or they face getting caught by the hooks in Section 290.

3) The Trap:

An unsatisfied statutory demand may lead to the liquidation of the company. It depends on the determination of the creditor pursuing the claim. However, depending on Court backlogs, the liquidation call may take many months to get before a judge and the company ends up in the hands of a liquidator.

Challenging a statutory demand is very risky, for both parties. If the challenge is successful the creditor will get costs awarded against them. If they lose, the judge has the discretion to declare that the company is insolvent, and order the immediate liquidation of the company.

An Example of the 290 Trap:

Superfurn (New Zealand) Limited, a furniture retailer, was issued with a statutory demand by one of its wholesalers, for US$42,000. Superfurn challenged this demand in Court, relying on Section 290. Unfortunately the judge found that the debt was not, in fact, disputed, and ordered Superfurn to pay the debt. When, one week later they had not done so, the company was promptly placed in liquidation.

Typically, a business with an expired statutory demand will be placed into liquidation by the Courts once the petitioning creditor brings an action. The unsatisfied statutory demand is proof that the company is insolvent.

Rebecca Hindwood is the Manager of Waterstone Recovery Ltd.

Proposal to Creditors – an alternative to bankruptcy

People facing bankruptcy have a number of choices:

If their debts are less than $40,000 they can seek the protection of the No Asset Procedure (NAP) or the Summary Installments Order (SIO).

This article looks at the third option, the personal compromise with creditors.

This process is similar to the Compromise with Creditors, part 14 of the Companies Act, but with one large difference. In the personal compromise case the High Court must approve the compromise.

A few terms first:

Insolvent:
A person who cannot pay their debts but who has not been made bankrupt.

Creditor:
A creditor who could prove their debt in the bankruptcy of the insolvent.

Proposal:
The document that outlines how the insolvent will divide their assets up between the creditors.

Trustee:
A person who will administer the assets of the Insolvent if the proposal is accepted. Termed a Provisional Trustee in the proposal.

The process can be outlined as such:

a) An insolvent, their lawyer or the provisional trustee drafts the proposal and lodges it with the High Court.
b) The Provisional Trustee calls a meeting of all known creditors.
c) If more than 50% of the creditors vote for the proposal, and those voting for hold over 75% of the total debt, the proposal is passed.
d) The Provisional Trustee takes the approved document back to Court, and a Judge must approve or decline the proposal.

Lets look at an example:

Aaron Zachary is the insolvent. He owns one house in his own name. It is worth $450,000, and it has $400,000 of debt on it. He also owns his car, and some shares in Telecom, worth $40,000.

Two years ago he lost a lot of money in a real estate project that went bad. He borrowed $300,000 from his wife's brother, Davis Polk. However, his marriage went bad after a misunderstanding concerning an attractive photocopier sales person, tequila, a mobile phone and a small spaniel called Blackie. Davis Polk has called up the loan and has got judgement in Court for the loan and a bankruptcy date has been set.

Aaron has $50,000 of other debt owed to various creditors.

Aaron also has a development company, Zachary Developments Limited (ZDL). The company shares are actually owned by the family trust. This company has a large development in Riverhead, and it is going really well. The land is worth $1,700,000, the debt to the finance company, Master Finance, is $1,500,000, and once the subdivision is complete the land will be sold for $2,000,000, leaving the company with a nice profit. However, there is no cash in the company, so no way to pay the $300,000. Aaron has personally guaranteed the debt to Master Finance.

All attempts to settle the loan are rebuffed. Often with references to Blackie.

In desperation, Aaron turns to an insolvency practice for help. The insolvency firm, "Stonewall Insolvency" comes up with a proposal where Aaron sells his Telecom shares to split equally between the $300,000 he owes to Davis Polk and the other $50,000 of creditors (14¢ in the dollar) and the trust that owns Zachary Developments Limited signs a deed that in 18 months it will chip in another $120,000 to go to the creditors, another 35¢ in the dollar. 49¢ in the dollar in total.

The deal is that the bank with the mortgage over the house will get nothing, they will just keep their security over the house, and likewise, Master Finance will get nothing. They have their security over the land in Riverhead.

At the creditors meeting Davis Polk is very unhappy. What really upsets him is that Master Finance, who is owed $1.5m but will get paid out in full, are allowed to vote. It is clear that Master Finance does not want to see Aaron bankrupt. They are worried it will distract him from completing the project.

The other creditors are not happy either, but they support the proposal.

Once the deal is agreed, the provisional trustee sends the document to the High Court for approval. David Polk's lawyer argues that there are three reasons why the court should not approve the proposal:

1) If Aaron was bankrupt the Official Assignee would sell his house, releasing $50,000 in equity, a better short term deal than that being proposed.
2) It is unjust that Master Finance is allowed to vote, as they stand to lose nothing and have no exposure.
3) Due to the close working relationship between the insolvent and Master Finance, that Master Finance should be declared a related party.

The court disagrees, and all the deal is passed.

None of this is required to be publicly advertised (such as in the NZ Gazette) however Veda Advantage can (and most likely will) include this information as an Insolvency on your personal credit report however there is no public database specifically devoted to listing all insolvents currently subject to an approved Proposal.

As a rule of thumb creditors receive nothing back from a bankruptcy.

It is very rare that bankrupts have any assets that the OA can seize. The amount of money typically recovered by the OA off bankruptcies is around $6m, spread over 3,000 bankrupts. (Last year it spiked to $26m, due to we believe, a spectacular one off recovery, the details no member of the tight lipped OA's office will divulge, despite this correspondent's most earnest endeavours!)

It is safe to assume most of the funds recovered would have been paid to secured creditors.

In short, if an Insolvent fronts up with a proposal, and that proposal is prepared by an Insolvency Practitioner, you can be fairly confident that the outcome will be better than anything to be delivered by the bankruptcy of the insolvent.

At Waterstone, we turn down more applications than we accept. We do not like to take on a proposal unless we are confident that the candidate is both honest and making a genuine attempt to do the right thing by his creditors.

Liquidation and GST:

Why the IRD is better than the Pied Piper when it comes to Land Sales

By Peter Drennan

Although the story of the Pied Piper has changed over the years, we'll stick with the original German version: Town employs the services of the Pied Piper to solve their rat infestation problem; Piper plays a magical tune which leads the rats off to the river where the rodents promptly drown. With the problem solved the townsfolk decide not to *pay the Piper*. In retribution, the Piper wields his magic tunes a second time, this time luring the town's children, with the exception of a lame child who could not keep up, and a deaf child who did not hear the magical melody, to the same fate shared by the rats.

Property developers, the town's residents in this morality tale, use the services of the IRD as their project progresses. Funds spent are claimed as expenses, revenue is in the form of loans and therefore not rateable. The IRD provides considerable funding to building projects, especially if that project firm is on an invoice basis and the developer is remiss in paying his bills. The IRD is the Pied Piper in this story. If the Piper is not paid at the end of the project, you can expect to hear the IRD tunes coming the developer's way.

But what happens when the town's residents fall into the hands of a liquidator prior to the debt to the Piper falling due, specifically where there is a mortgage on the land greater than the value of the property? This article deals with this question.

There are two factors at play here: The Time of Supply and the Principal Purpose of the asset.

Does GST attach to this asset?

For real estate transactions the question of 'principal purpose' is an essential one to address. If the property is purchased with the principal of purpose being to make taxable supplies then a GST refund can be claimed when the purchase is made. Taxable supplies in regards to property will include leasing the property for commercial use, for example the leasing of an office block or a factory would be a commercial use, and the tenants rent payments would include a GST component. Taxable supply does not include leasing to tenants for residential accommodation, therefore the purchase of a residential investment property would not give that entity the right to claim a GST refund for that purchase. If however the purchase of a residential property had the principal purpose of development then this will be a taxable supply.

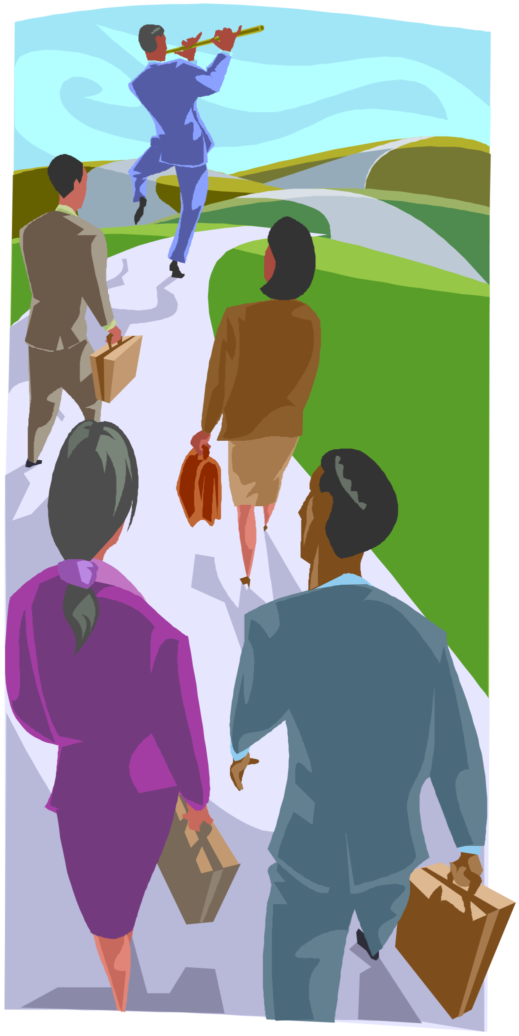
As an example to illustrate this distinction take the purchase of a large warehouse:

Purchaser A buys the warehouse and leases it out to an appliance manufacturer. The property is then sold to Purchaser B who develops the property into residential apartments at the expiry of the lease. Purchaser C then acquires one of the apartments and leases it out to a Swedish couple. In this example Purchaser A and B would have the principal purpose of making taxable supplies and as such could claim a GST refund on the purchase price, however purchaser C could not.

A complication to the scenario is the ability of GST registered entities to make the sale of a property zero rated. Zero rating basically allows the purchaser not to pay GST on their purchase, and as such the vendor need not account to the IRD for that GST component. The logic is sound as GST is effectively an end consumer tax, so where two GST registered entities enter into a transaction it is basically a zero sum game anyway as the vendor would account to the IRD for the GST, and the purchaser would get a GST refund. However for a property transaction to be zero rated the following criteria must be met (as taken from the IRD website):

- It must be the supply of the whole or stand-alone part of a taxable activity, from one registered person to another.
- It must be the supply of all the goods and services necessary for the continued operation of the activity.
- Both parties must agree in writing that there is a supply of a going concern.
- Both parties must intend that the activity is capable of being carried on as a going concern by the purchaser.
- The business must be a going concern at the time of supply and carried on up to the time of the transfer to the purchaser.
- Both entities must be registered for GST

So in our example above the sale from A to B could be a zero rated transaction as B could continue the going concern as there



is a commercial lease in place. B need not actually continue the going concern as long as it is capable of been carried on as a going concern.

When does GST attach?

The second issue is when does the GST attach? Crucial to the concept of GST upon liquidation are the rules relating to Time of Supply. The basic rule is that the time of supply will be the point at which any payment is received, or an invoice is issued (depending on whether the entity is registered on an invoice or a payments basis). In terms of real estate transactions payment includes any deposit paid to the vendor or an agent of the vendor (e.g. a real estate agent). Or the time at which an unconditional contract is entered into, whichever is first in time. The time of supply will determine in what period the entity must account for the transaction in their GST return.

And Liquidation...

With these basic rules of GST we can now approach the question of GST upon liquidation. Following these basic rules it is easy to identify situations where Liquidators trying to realise property may find themselves having to pay the piper. Any situation involving the sale by the liquidator of commercial property will create a potential GST liability to the IRD.

In our examples above:

Purchaser A Liquidates:
The liquidator, when selling to the Appliance Manufacturer, will be liable to account for the GST component. However, by claiming that the lease to the Appliance Manufactures is going concern, GST can be avoided.

Purchaser B Liquidates:
The liquidator again will be liable to account for the GST component unless they sell the business (including the land) as a going concern.

Purchaser C Liquidates:
No GST will apply here, as the sale is to residential users, and no GST applies.

If in one of these situations GST is payable to the IRD and the liquidator fails to account for this from the proceeds of sale then they may find the piper asking for the money in the months following the sale.

In situations where the proceeds of sale have already been distributed, possibly to a mortgagee for example, then the piper will calmly lay claim to the children (the liquidator's personal assets).

What about the mortgage?

The final variation to be considered is the involvement of a Mortgagee. Under the Goods and Services Act 1985 a Mortgagee must account for GST to the IRD unless they receive a written statement from the mortgagor stating that if the property had been sold by them, then the transaction would not have created a GST liability to the IRD, with appropriate reasoning. Alternatively the mortgagor must determine that this would have been the case also with their reasons. The analysis from the preceding paragraphs will provide the basis for these statements.

If the Mortgagee cannot obtain or produce a written statement to this effect then the GST will be considered a cost of the sale of the land and the mortgagee will be held liable to account for it to the IRD, even in situations where the sale price will be insufficient to meet the debt to the mortgagee. So here we plainly see the claim for the GST by the IRD taking priority over the secured creditors claim.

There are two cases on point:

In the Commissioner of *Inland Revenue vs Edgewater Motel Limited* the High Court found the proceeds from a mortgagee sale had to be receipted back to the IRD for GST before the balance could be receipted to the mortgagee. This was appealed and the Court of Appeal upheld the lower court's decision.

In the second case, *Rob Mitchell Builder Limited vs National Bank New Zealand*, Bob the builder had sold the property, but the sale had not been completed when the company was placed in liquidation.

The liquidators sold the property, and with the consent of the bank and the IRD placed the balance of the funds into a trust account until the issue was resolved by the courts.

The court ruled that the full sale price of the property (including GST) was an asset of the company to be distributed by the liquidator. As the mortgagee is a secured creditor in the liquidation, and the IRD merely has a preferential status, then the mortgagee will receive their funds prior to the IRD receiving their GST. As the time of supply arises prior to the liquidation, neither the liquidator or the Mortgagee will be liable to the IRD for the GST, and the Piper is left lurking around the empty kindergarten where there are no children available for abduction.

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A Nice Light Body

Many of us have heard of a Romalpha clause. Romalpha is a firm forever famous for losing a case to their Dutch aluminium supplier.

Alas for the Dutch, their company had the rather dull name of Aluminium Industrie Vaasen BV. But the 'Aluminium Industrie Vaasen clause' was never going to take hold.

Back, to the present. Last year the courts came up with a great little judgement, which is now referred to as simply "Lightbody".

The facts are these:

Mr Lightbody was a director of a struggling firm called Capro. The firm made jewellery. The firm received goods from a supplier called Regal Castings.

Back in 1998 Mr Lightbody and his good wife decided to gift the family home to a trust. This they did, and over the next seven years they gifted the total value of the house to the trust. Come 2002, the trust owned the house outright. In 2003 Capro went into liquidation.

Regal Castings were out of pocket $160,000 and sought to rely on their personal guarantee. They proceed to bankrupt Mr Lightbody and then challenged the transfer of the house to the family trust.

The High Court agreed with Mr Lightbody.

The Court of Appeal agreed with Mr Lightbody.

The Supreme Court decided in favour of Regal Castings, and ordered that Mr Lightbody's half share of the property be returned to the Official Assignee for the benefit of Mr Lightbody's creditors.

The Supreme Court relied on Section 60 of the old Property Law Act, now covered by sections 345 to 348 of the revised Property Law Act.

As a firm that spends much of our time having to explain to creditors why they cannot get access to a shonky director's assets that he has hidden in a trust, we are delighted at this ruling.

Personal Liabilities of Liquidators, Receivers and Administrators

One of the joys of working in insolvency is the personal liability that attaches to much of what we do. There are three broad areas that Insolvency Practitioners work in, Receiverships, Liquidations and Voluntary Administrations, and the personal liability differs in each case. Naturally, an Insolvency Practitioner is never liable for any company debts incurred prior to his or her appointment. Personal liability accrues only once the appointment is accepted.

Liquidations

Typically, a liquidator is not personally liable for any costs incurred by the business while it is in liquidation, and for an Insolvency Practitioner this is the safest form of insolvency to work in.

Indeed, when it comes to essential supplies Section 275 of the Companies Act makes provisions that the providers of this service not only must supply, but that they cannot demand a personal guarantee from the liquidator in consideration of the risks they face in supplying a company in liquidation.

In liquidation there are two areas where a liquidator may be held personally liable:

Getting It Wrong

Schedule Seven and related pieces of legislation and volumes of case law determine what a liquidator must do with the money recovered through the process of liquidation. If a liquidator gets it wrong, they can be held personally liable. In the Sleepyhead case the liquidators of King Rob Limited sold mattresses for $26,000 and disposed of the money to the GSA holder. Sleepyhead had a PPSR over the assets, and the Court found the liquidators paid the $26,000 to the wrong party. They were held personally liable to Sleepyhead for $26,000.

Something to keep all liquidators awake at night, no matter how soft the mattress.

Section 301

Section 301 covers directors, promoters, managers, liquidators and receivers of companies, and hold them liable for losses incurred by the company where any of the above named converts assets of the company. Simply put, if a liquidator absconds with company goods or money, the courts can hold the liquidator personally liable.

Receiverships

The rule for receiverships is straight forward. A receiver is personally liable for all costs incurred by him during the course of his receivership. The receiver is also indemnified by the assets of the company to cover any exposure.

A receiver that elects to run a business once he is appointed faces personal exposure for all the costs he incurs as a receiver.

There are two exceptions.

The first is for employment contracts. Receivers are not liable for the first two weeks pay for any existing staff member provided that they cancel the contract in the first two weeks of their appointment.

The second is rent. Receivers are liable for rent that accrues two weeks after their appointment. Thus, receivers have two weeks to cancel rental contracts, or become liable for the cost of the rent. Importantly, the law states that although the receiver is liable for the rent, he is not liable for any other obligations under the rent.

More generally, if a contract is in place and it is not a lease or an employment agreement, then the receiver is not personally liable unless she explicitly binds himself to that agreement.

Voluntary Administration

The personal liability for Voluntary Administrators is very similar to that of receivers, with the rules relating to employee agreement and leases virtually identical to that of receivers except that for leases a Voluntary Administrator has only seven days and not 14 to identify and cancel leases.

Importantly for the lease agreements, the Administrator is liable even if they cancel the lease but the business is still operating the premises. Thus, if a Voluntary Administrator wishes to escape personal liability for a lease they must both identify the lease and evacuate the premises within seven days. The Act is silent on the issue of knowledge, meaning that the Administrator is deemed to be aware of all the leases. If there is a lease in place but the Administrator is unaware of this, they are liable for this cost despite not being aware of it.

Once a company comes out of Voluntary Administration, typically within six weeks and either into liquidation or back to the board by way of a DOCA, then the personal liability for the Administrator ends.

Reason for Liability

There is a good public policy for the personal exposure of Receivers and Administrators.

In both Receivership and Voluntary Administration there are often expenses that need to be incurred to realise the value of the business assets.

By making the Insolvency Practitioners personal liability it has the following three public policy gains:

- Minimises the further risk to creditors of ongoing losses.
- Gives confidence to suppliers to the distressed businesses and ensures the continued supply of goods and services needed to achieve a positive outcome for the wider body of creditors.
- Forces Insolvency Practitioners to be prudent in their business decisions

For both Receivers and Administrators, the legislation provides for the Court to grant an extension to the time frames relating to employment contracts and leases.

Waterstone Saves Christmas

In April the High Court ordered the Mrs Christmas hamper company be placed in liquidation. This company was built on a tried and tested business model of collecting money from customers in advance and delivering to the customer a hamper at the end of the year. The business had operations in Australia well as in New Zealand, and at the time it failed there was some 3,000 customers who were making payments into the company.

Not exactly Santa Claus.

There was a fair bit of opportunistic publicity from some rival companies leading up to the liquidation.

On site we faced a number of challenges. It was quickly apparent that the company had no value, but that there was 3,000 customers who had paid in a million dollars in anticipation of receiving hampers at the end of the year.

As is often the case in a liquidation, a quick decision had to be made. We took stock of the numbers, and decided to trade the business on in the hope of getting a sale. The decision had positive and negative impacts.

On the positive side, we managed to sell the customer base to Chrisco. The management team at Chrisco took a long-term view of the customers and decided that, in addition to the value to their business, there was an important need to protect their industry as well. Chrisco undertook to credit the payments made by the customers to their Mrs Christmas account to a Chrisco account.

Given that the prospects of getting a recovery from the liquidation was virtually nil, this was an excellent deal for the customers. We were very fortunate that the company had failed relatively early in the year, as for those customers who signed on to Chrisco would continue to make payments through the rest of the year to the new supplier.

On the negative side, the value of the sale proved to be less than the cost of running the business long enough to get the sale done. In hindsight, we would have made the same decisions, but the challenge of running a live liquidation is that you have imperfect information and a need to make decisions on the go.

The IRD Preference

In a liquidation the IRD will receive a dividend from the recovery of unsecured assets after the liquidator's costs and outstanding staff wages, but ahead of other unsecured creditors.

There has been some talk of removing the IRD preference and the gossip around the traps is that the new Government is giving this some credence.

Humbly, we disagree. And we have three reasons for this.

Taxes Must Be Paid

There is some woolly thinking about that Government services are provided by magic pixies. Let me quote our illustrious Prime Minister:

"...in the end someone has to pay the bill - and there aren't little pixies at the bottom of the garden printing cash."
John Key

There is broad agreement that the Government should provide services. We may all take a different view as to what those services are and how the IRD should collect the revenue to pay for these services, but with the exception of Lindsay Perigo, most of us expect that the New Zealand state has obligations, and those obligations require cash.

With that in mind, I come to the second reason.

The IRD is an involuntary creditor

If you supply goods or services to a company that subsequently fails, then that was your choice. You would have made some checks, (or possibly not), weighted up the commercial risk of not getting paid against the profit to be made, and elected to supply.

The IRD has no such discretion. The IRD must provide credit to businesses. In the case of some firms, especially property developing firms, it even provides funding in terms of GST refunds, hoping to recoup the money when the development is complete. It is wrong for the IRD to then rank alongside other creditors when it comes time for the distribution of the company assets. From Waterstone's perspective, we would rank staff below the IRD if we had our way. It sounds harsh, but staff should know more than others that the company is in trouble, and indeed sometimes it is the staff that contribute to the failure.

Funding Creditors

Changes to the legislation at the end of 2007 have allowed unsecured creditors who elect to fund the liquidation in recovery action to gain a priority over the IRD. We believe that this creates an opportunity for unsecured creditors who wish to become actively involved in the recovery efforts.

Therefore, the IRD should retain its preference.

Five fun things we bet you did not know about Insolvency

1) The wise heads at the Ministry of Economic Development have increased the maximum amount liquidators can pay to staff members for holiday pay and outstanding wages.

   It was $16,420, it is now $18,700.

2) Court appointed liquidators are only allowed to charge $200 per hour unless we have the court's approval.

3) Suppliers of essential services (power, gas, telecoms) are obligated by law (Section 275 of the Companies Act) to keep supplying firms in liquidation, and cannot ask for a personal guarantee from the liquidator.

4) If there is a creditors petition to change liquidators at a creditors meeting, the liquidators are not allowed to lobby for votes!

5) A recent survey revealed that New Zealand Insolvency Practitioners were 24% thinner than our Australian contemporaries, with better hair and sunnier dispositions.