



Corporate Liquidations – Are you Exposed?

Suppliers to companies that fall into liquidation are exposed to a liquidator clawing back amounts paid to them. It is not only suppliers of goods and services who are exposed but also landlords, licensors or IP, lessors of plant and equipment, and unsecured lenders. Dividends paid to shareholders might also be recovered.

A liquidator's powers of recovery reside in the voidable transaction provisions in the Companies Act 1993. Fortunately there are steps available to suppliers and the like that will protect them in many instances. I discuss those steps further below but first outline the scope of the problem.

What amounts can a Liquidator recover?

Broadly, a liquidator may recover any amount paid out by an insolvent company at any time in the 2 years prior to the company being put in liquidation (proposals are afoot to reduce this period to 6 months for third parties and to increase it to 4 years for related parties). The liquidator's right to do so is, however, constrained by two important limitations:

- a. an amount may only be recovered where and to the extent that it enables a person to receive more than the person would receive in the company's liquidation;
- b. third parties who, in good faith, transact with the company for value and who were at the time unaware of the company's insolvency are protected.

Third Party Suppliers

The good faith for value carve out protects third parties provided they had no knowledge of the company's insolvency. In most cases, however, their state of awareness changes, for example where a tenant seeks rental relief from its landlord. The issue then becomes whether a payment to the person has preferential effect.

No Ordinary Course of Business Exception

A significant legislative change was made in 2006 to remove the exception for transactions entered into in the ordinary course of business. Prior to that amendment, a transaction could not be set aside by a liquidator as a transaction having preferential effect if it took place in the ordinary course of business.

Transactions as part of Continuing Business Relationship

In substitution for the ordinary course of business test there is an alternative form of protection for persons transacting with a company. This broadly protects persons (for example raw material suppliers, landlords, lessors of plant and licensors of IP) whose continued support is, for commercial purposes, integral to the company's business. Protection is available to the extent that the transactions involve an equal exchange of value and do not afford a preference.

Related Parties

The voidable transaction provisions leave related parties particularly exposed. They will inevitably have knowledge of the company's state of insolvency and repayments of shareholder loans and dividends paid to shareholders in the 2 year period leading up to liquidation will invariably be recoverable.

Protective Steps

There are protective steps that a person providing value to an insolvent company can take. Possibly the most effective protective measure is to obtain payment from the shareholder (or group company) and not from the insolvent company itself. For related parties, protection may be available via steps legitimately taken to securitise their position by way of a GSA or charges over specific assets in support of shareholder loans.

Review

Third parties and related parties alike are well advised to review their arrangements with companies whose solvency is in question. They should then explore whether any steps are open to them to shelter them against the risk of a liquidator subsequently being appointed to the company and recovering amounts from them. I would of course be happy to assist you with that review on a fixed fee arrangement. My details are provided below if you wish to explore that.

Peter Speakman

Principal

Telephone: 09 973 0577

Mobile: 021 854 642

Email: peter@speakmanlaw.co.nz