



## Protections for Owner Operated Companies

There are steps open to you as owner of a trading company to protect your investment in the company.

Below, I set out the protections that are available to you and discuss how you can take advantage of them.

### 1. Debt Moratorium

An initiative announced by the Government on Friday is a moratorium on existing debts. The moratorium allows companies to freeze existing debts for 6 months; Creditors are precluded from enforcing their debts against the company for that period.

The fall in a company's revenue due to Covid 19 consequences will, for many companies, see them fall behind with their trading and bank debt. A moratorium will certainly help them.

Companies may take advantage of the moratorium (the Government calls it debt hibernation) with support of 50% of creditors, by value and by number.

Care will be needed in presenting the proposal to creditors. They are not compelled to approve it and will need to be persuaded of the merits of it.

Debts covered by the moratorium are not extinguished, instead the company's obligation to pay them is deferred. Creditors will likely only approve the moratorium proposal if they can be satisfied:

- a. That the company's trading prospects post Covid 19 effects are likely to enable the company to pay its debts once the hibernation ends; or
- b. An asset sale or recapitalisation is imminent and sufficient to generate the cash needed in the business.

Plainly, financial projections, either with or without an asset sale or recapitalisation will underpin the success of the proposal.

### 2. Securitise your Investment

To the extent capital in your company is represented by shares, consider converting them to debt. By doing so, you will then be able to take security (a GSA) over it and afford yourself priority in liquidation (should that eventuate) ahead of unsecured creditors. Discuss this with your bank as a first step, it will likely breach bank covenants but bank approval should follow where your security is subordinated to that of the bank.

This can be achieved by having the company repurchase your shares and then reinvesting the proceeds as debt capital, secured by a GSA (usually with interest accruing and not paid, so as to assist in garnering bank support). A share repurchase may have tax consequences (dividend rules need to be considered) but correctly structured, these can be overcome.

Where this is not possible, either because bank approval is not forthcoming or other obstacles stand in the way, then at least ensure that additional shareholder investment you make into the company is by way of secured debt and is not by way of share capital.

### **3. Prioritise Essential Payments**

A second initiative announced by the Government on Friday relieves directors from personal liability for continuing to trade the company during insolvency. This will protect directors against creditor claims in any subsequent liquidation.

Directors must still act in good faith but nevertheless it will give them flexibility to direct payments where they are most needed (employees for example). They may do so without fear of personal cost in the event all goes wrong. Directors might elect to direct payments to suppliers who might otherwise decline to continue to supply the company.

Under another of the Government's announcements on Friday, those suppliers need not fear a clawback of the payments they receive by a liquidator under the voidable transactions provisions in the Companies Act (existing law offers some protection here; the Government's announcements go further).

### **4. Creditor Compromises**

The Companies Act accommodates creditor approved compromises. Usually these involve a pro rata cancellation of part of a company's debt. Alternatively, they might involve larger creditors agreeing to a disproportionately greater write off than smaller creditors.

A compromise proposal can be initiated by the directors where they believe the company is unable to pay its debts.

The proposal must be sent to all creditors and must include information about existing creditors and a statement of what is proposed should happen to the debts owing to them. The proposal can affect all creditors or only a class of creditors. Approval is required by a majority comprising 75% in number and in value of the creditors in the class affected. If approved it will bind all creditors who are within the class to which the proposal applies.

As with the debt moratorium, care is required in presenting the proposal to creditors and obtaining their buy-in. Again, financial projections and/or an asset sale or recapitalisation will be essential.

### **5. IRD Relief**

Have you considered an instalment arrangement for IRD debt? These are specifically provided for in the Tax Administration Act. In the circumstances the IRD can be expected to be accommodating, more easily than historically at least.

Instalment arrangements of 6 to 12 months are most common. However, in my experience it has been possible to enter into them for longer. In some cases I have witnessed 2 to 3 year instalment arrangements. Their principal benefit, other than to relieve financial pressure, is that they put a stop to late payment and other penalties during the instalment period.

### **6. Factoring Debtors**

Short term financing may be available via factoring your debtors. One of my clients operates in this field, generally offering 90 day terms. I would be happy to put you in touch with them if you need.

If I can be of assistance in any of these areas, feel free to give me a call for a discussion of what might best suit your circumstances. Alternatively email me.

Finally, I sincerely hope you and your families are keeping safe and well.