

Director's Duties- Business Solvency Update

Solvency risk is a key consideration for many company directors in the current environment. Solvency issues arise when a business cannot meet its financial obligations as they fall due even after disposal of its assets. To satisfy solvency test provisions of the Companies Act 1993:

1. A company must be able to pay its debts as they become due in the normal course of business and
2. The value of its assets must be greater than the value of its liabilities (including contingent liabilities).

If in doubt, we recommend you seek advice sooner rather than later.

Immediate formal or informal insolvency processes including liquidation are necessary considerations for directors where a business is unable to pay its debts or is (close to) insolvent.

More important than ever - Is your business distressed?

In a recent and significant decision in *Debut Homes Limited (in Liquidation) v Cooper [2020] NZSC 100*, the Supreme Court held the director financially liable and ordered to pay \$280,000 to the creditors in the liquidation for a breach of statutory duties under the Companies Act 1993.

Directors have statutory duties including;

1. To act in what they consider to be the best interests of the company.
2. Not to allow business to be carried on in a manner likely to create serious risk of loss to creditors.
3. Not to enable the company to incur obligations unless the director believes on reasonable grounds that the company will be able to perform them.



ASHTON WHEELANS

In this decision, the Court took the view that once a company is in a position where continued trading will result in a shortfall to creditors and it is not salvageable, the continued trading is a breach of directors' duties. Additionally the Court formed the view that it did not matter that continued trading improved the outcome for some creditors, as all creditor's interests needed to be considered. When experiencing financial difficulties Directors can choose to employ informal mechanisms but these must align with formal mechanisms, which would include consultation with all affected creditors.

The directors' duty- *to not incur obligations without reasonable belief that the company will be able to perform the obligations as they fall due* was discussed by the Court noting that this duty is not limited to contractual obligations and can, for example, include GST. It follows that Directors need to think very carefully before taking on new debt to repay old debt (eg related parties and secured creditors). Directors' actions will not be viewed favorably where, as the Court commented, they are "robbing Peter to pay Paul."

Considerations for Directors

1. Business Readiness – Is your business?
 - Currently vulnerable and dependent upon favourable business, financial, and economic conditions to meet its financial commitments?
 - Highly vulnerable by being unable to pay creditors when they fall due?
 - Unable to pay one or more of its financial obligations when due?
2. Actions you can take can include
 - Boost your sales- run a sales campaign.
 - Sell surplus assets
 - Cut back on discretionary operating expenses.
 - Increase owner equity
 - Talk to the Inland Revenue about how they can support your cash flow and tax.
 - Seek independent advice – The Companies Act 1993 provides that a director may rely on professional advice if acting in good faith amongst other things.

At Ashton Wheelans we can identify the resources your company needs and other turnaround strategies and discuss formal insolvency processes whether it relates to;

Business Advisory and Restructuring
Voluntary Administration
Receivership

Government Support
Creditor Compromises
Liquidation



Contact Andrew Oorschot for a free, no-obligation, initial meeting.

Email: andrew.oorschot@ashtonwheelans.co.nz
Phone: 03 964 7205
Cell: 021 964 720