

Meltzer Mason Heath

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UPDATE + NEWS + REVIEW

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Economic Reality and "Short Form" Liquidations Revisited

Karen Mason

The first quarter for 2006 has started with a hiss and a roar, and as predicted many small businesses are feeling the effects of the declining economy. Most are still geared up for a good turnover, but unfortunately, and as if overnight, future contracts have dried up. Those businesses are now left with unproductive staff, unnecessary equipment, and more alarmingly, bank debt secured over the family home and not over the assets of the company. In a liquidation we can deal with everything except the personal loan to the company, which of course is unsecured and this has a devastating effect on the shareholders/directors personally.

Question: Why was this loan to the company not covered by a General Security Agreement (GSA) before it was advanced by the shareholders? This is such a simple, inexpensive procedure, that will ultimately protect the family home. Steps should be taken now to protect clients, as the banks and financiers are sharing the risk with the borrower—especially with Auckland's inflated property market values.

This is not the only issue that has been alarming. This year (in only 3 months) we have seen over \$10 million of IRD debt, mostly GST and PAYE. This is a huge sum spread over no more than 20 liquidations.

Question: Was business really booming as we thought? Were businesses struggling as far back as mid 2005? And how was it allowed to escalate to the proportions it has?

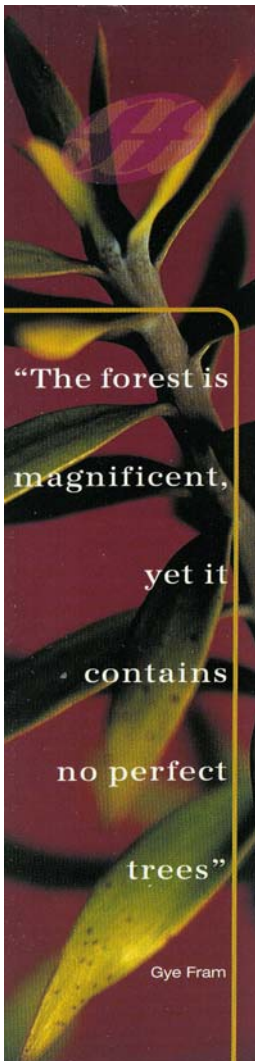
There is a saying that always comes back to me when I see people struggling needlessly in business (and life in general)... **"This life is not a practice run!"** If an insolvent company recognises its problems earlier rather than later, the less damage can be done to everyone.

As promised last year (MMH newsletter December 2005) we have sought clarification regarding "Short Form Liquidations" and IRD's BR Pub 05/14.

It is correct that the ruling now allows for a distribution of capital gains (tax free) provided that the appropriate resolutions to cease business, pay all creditors, distribute the surplus assets and to have the company removed from the Register predate any distribution of assets. The signing of these resolutions is the first step legally necessary to achieve liquidation.

The ruling confirms the IRD position. However, risks remain as if the company were merely removed from the Register and the company can still be reinstated to the Register by a creditor who can appoint their own liquidator. It does make sense to use this method if there are no risks (contingent or otherwise) back to your client or yourself. But not if you are dealing with large sums for distribution to shareholders. Several solicitors have related to us that it can take anywhere from 6 months to 2 financial periods to get IRD clearance. IRD clearance of course, is not necessary in a liquidation scenario. All round, a liquidation remains a safer and probably quicker option.

The part that I don't like the most with these "short form liquidations" is the ability of the IRD to reverse the ruling and tax will then be payable. (Remember, this is a ruling only and not law). Albeit that no interest or penalty would apply, tax would be owing. This would never be owed or payable on a liquidation.



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More on Personal Property Securities

Arron Heath

The personal property securities legislation continues to provide us with interesting questions and issues. Suppliers should note that:

1. Registration, on its own, does not establish a valid security interest. Registration on the PPSR is only notice of a security interest – it does not create the interest. There must also be an enforceable security agreement.
2. What constitutes an enforceable security agreement? Are terms of trade printed on the back of invoices enough? Probably not.

Section 36 of the Personal Property Securities Act requires that, to be enforceable against third parties, the debtor must have assented in writing to the terms of the security agreement. In the absence of written agreement a supplier's "terms of supply" are not enforceable against third parties. Although a course of conduct is enough to establish a contract between debtor and supplier, some form of written acceptance of the "terms of supply" is required for that contract to be enforceable against third parties.

3. How detailed does the description of the collateral in the written security agreement have to be?

The Personal Property Securities Act (Section 36) says that the written security agreement must contain "an adequate description of the collateral by item or kind that enables the collateral to be identified".

A general description is probably sufficient as the description does not operate as the sole way to identify the supplier's goods. As the agreement is not registered other creditors are not reliant on it. The description need only be consistent with the goods.

Without Prejudice Correspondence

Arron Heath

A NZ Lawyer article last year contained some interesting comments regarding the use (and abuse) of "without prejudice" correspondence.

Labelling a document "without prejudice" does not by itself automatically protect the document. The communications must be made in the context of genuine settlement negotiations.

It is incorrect to use the label in a purely commercial (e.g. no dispute) situation. It is often wrongly used, for example, on letters which state a party's rights in a dispute, rather than its proposals for settlement.

If a letter is going to the other party in connection with the settlement of a dispute, but there is still a chance of the dispute going to Court, then a number of steps can be taken to ensure that it attracts this privilege:

- it is clearly marked "without prejudice";
- it contains at least one serious proposal for settlement; and
- it contains no incorrect statements about any matter, no admissions about any unrelated matter, and no threats of unlawful conduct.

Where the position is being protected is that of a company in the course of performance of a contract the letter should not be labelled "without prejudice". Instead, statements like "ABC Company reserves all its rights in relation to the contract", or "without prejudice to your obligation to perform this part of the contract, we will accept (e.g. delay of one month etc)".

Between the professional staff at Meltzer Mason Heath there is over 95 years insolvency experience. This means that any problems or uncertainties facing your clients will have been seen by us before. Please call us, and as always we will offer you and/or your clients a free one hour consultation.

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