



Liquidation: A Guide for Creditors



Liquidation: a guide for creditors

If a company is in financial difficulty, its shareholders, creditors or the court can put the company into liquidation under the provisions of the Companies Act 1993 (“the Act”).

This information sheet provides general information for unsecured creditors of companies in liquidation.

Who is a creditor?

You are a creditor of a company if the company owes you money. Usually, a creditor is owed money because they have provided goods or services, or made loans to the company.

An employee owed money for unpaid wages and other entitlements is a creditor.

A person who may be owed money by the company if a certain event occurs (e.g. if they succeed in a legal claim against the company) is also a creditor, and is sometimes referred to as a ‘contingent’ creditor.

There are generally two categories of creditor: secured and unsecured.

- A secured creditor is someone who has a ‘charge’, such as a mortgage or a General Security Agreement (“GSA”), over some or all of the company’s assets, to secure a debt owed by the company. Lenders usually require a charge over company assets when they provide a loan.
- An unsecured creditor is a creditor who does not have a charge over the company’s assets.

Employees are a special class of unsecured creditors. In a liquidation, some of their outstanding entitlements are paid in priority to the claims of other unsecured creditors.

All references in this information sheet to ‘creditors’ relate to unsecured creditors unless otherwise stated.

The purpose of liquidation

The purpose of liquidation of an insolvent company is to have an independent and suitably experienced person (the liquidator) take control of the company so that its affairs can be wound up in an orderly and fair way for the benefit of all creditors.

There are two types of insolvent liquidation:

- voluntary liquidation, and

- Court liquidation.

A voluntary liquidation, begins when Directors or shareholders resolve to liquidate the company and appoint a liquidator. The liquidator must send a First Report to all known creditors within 5 working days of being appointed.

In a court liquidation, a liquidator is appointed by the court to wind up a company, following an application, usually by a creditor. Others, including a director or a shareholder, can also make an application to the court for liquidation. The liquidator must send a First Report to all known creditors within 20 working days of being appointed.

After a company goes into liquidation, unsecured creditors can no longer commence or continue legal action against the company, unless the court permits. It is possible for a company in liquidation to also be in receivership.

Who can be a liquidator?

Actually, the correct question is “Who cannot be appointed or act as liquidator for a company”? This is covered in s.280 of the Act and whilst there are a number of restrictions, the main ones are as follows:

Unless the Court orders otherwise,

- a person less than 18 years old;
- a creditor of the company;
- a person who, within the 2 years immediately preceding the commencement of the liquidation was a shareholder, director, auditor or receiver of the company;
- a person who has, or whose firm has, within the 2 years immediately preceding the commencement of the liquidation provided professional services to the company (unless the company is solvent);
- a person who has, or whose firm has, within the 2 years immediately preceding the commencement of the liquidation had a continuing business relationship (other than providing banking or financial services) to the company’s majority shareholder, any of the company directors or any of the company’s secured creditors (unless the company is solvent);
- a person who is, or is deemed to be, subject to a compulsory treatment order made under Part 2 of the Mental Health (Compulsory Assessment and Treatment) Act 1992;
- an undischarged bankrupt or a person who is prohibited from being a director or promoter of, or being concerned or taking part in the management of a company or Incorporated Society;

may not be appointed liquidator of the company.

The liquidator's role

When a company is being liquidated because it is insolvent, the liquidator has a duty to all the company's creditors. The liquidator's role is to:

- take possession of, protect, realise and distribute the company's assets
- investigate and regularly report to creditors about the company's affairs, including any voidable transactions which may be recoverable, any uncommercial transactions which may be set aside, and any possible claims against the company's officers. Such Reports are to be published on the Companies Office website.
- enquire into the failure of the company and possible offences by people involved with the company and report to the Registrar of Companies or Financial Markets Authority
- after payment of the costs of the liquidation, and subject to the rights of any secured creditor, distribute the proceeds of realisation — first to preferential creditors, including employees, and then to unsecured creditors, and
- request that the Register of Companies remove the company from the Register on completion of the liquidation.

A liquidator gets paid out of the assets of the company.

If the company is without sufficient assets, one or more creditors may agree to reimburse a liquidator's costs and expenses of taking action to recover further assets for the benefit of creditors.

In this case, if additional assets are recovered, the funding creditors can be compensated for the risk involved in funding the liquidator's recovery action.

Recoveries from creditors

A liquidator has the ability to recover, for the benefit of all creditors, certain payments (known as voidable transactions) made by the company to individual creditors in the six months before the start of the liquidation. Refer to s. 292 of the Act.

Broadly, a creditor receives an unfair preference if, during the six months prior to liquidation, the company is insolvent, the creditor suspects the company is insolvent, and receives payment of their debt (or part of it) ahead of other creditors. To be an unfair preference, the payment must put the creditor receiving it in a more favourable position than other unsecured creditors.

In some circumstances, transactions that occurred up to 2 years before the commencement of the liquidation can be deemed to be preferential and recovered by a liquidator.

Not all payments from the company to a creditor in the six months before liquidation are unfair preferences. The Companies Act provides various defences to an unfair preference claim.

Creditors' meetings

A liquidator may call a creditors' meeting from time to time to inform creditors of the progress of the liquidation, to find out their wishes on a particular matter, to appoint a replacement liquidator, or seek approval of the liquidator's fees. Refer to s.243 of the Act.

A creditors meeting may be either a meeting in person, or a meeting by way of audio or audio and visual communication, or by way of postal ballot. Refer to Schedule 5 of the Act regarding proceedings at creditors meetings.

You may also use a creditors' meeting to ask questions about the liquidation and inform the liquidator about your knowledge of the company's affairs, or to vote to replace the liquidator.

The liquidator is not required to call a creditors' meeting if they give notice of that decision to all creditors unless a creditor requests the liquidator in writing to do so within 10 working days of receiving the liquidator's notice, in which case the liquidator must call a creditors' meeting.

Voting at a creditors' meeting

To vote at a creditors' meeting you must lodge details of your debt or claim with the liquidator. The liquidator will provide you with a claim form to be completed and returned before the meeting.

The chairperson of the meeting, usually the liquidator but not necessarily so, decides whether or not to accept the debt or claim for voting purposes. The chairperson may decide that a creditor does not have a valid claim or the amount of the debt cannot be determined with any certainty at the date of the meeting. In this case, they may not allow the creditor to vote at all, or only to vote for a debt of \$1. This decision is only for voting purposes. It is not relevant to whether a creditor will receive a dividend.

A quorum is present if three creditors who are entitled to vote are present or have cast postal votes, or if the total of creditors entitled to vote is less than three, all of those creditors are present or have cast postal votes.

Refer to Schedule 5 of the Act.

Voting by proxy

You may appoint a proxy to attend and vote at a meeting on your behalf. Creditors who are companies will have to nominate a person as proxy so that they can participate in the meeting. This is done using a form sent out with the notice of meeting. The completed proxy form must be provided to the liquidator before the meeting.

You can specify on the proxy form how the proxy is to vote on a particular resolution and the proxy must vote in accordance with that instruction. This is called a 'special proxy'. Alternatively, you can leave it to the proxy to decide how to vote on each of the resolutions put before the meeting. This is called a 'general proxy'.

You can appoint the chairperson to represent you either through a special or general proxy.

Voting Result

A resolution is passed if:

- more than half the number of creditors who are voting (in person or by proxy) vote in favour of the resolution, and
- those creditors who are owed more than 75% of the total debt owed to creditors at the meeting vote in favour of the resolution.

Liquidation committee

In both types of liquidation, the liquidator may ask creditors if they wish to appoint a liquidation committee and, if so, who will represent the creditors on the committee. Refer s.314 and 315 of the Act.

A creditors committee assists the liquidator, approves fees and, in limited circumstances, approves the use of some of the liquidator's powers, on behalf of all the creditors.

Committee meetings can be arranged at short notice, which allows the liquidator to quickly obtain the committee's views on urgent matters.

Liquidator's fees and expenses

A liquidator is entitled to be paid for the work carried out on the liquidation, but only if there are assets available.

The court has the power to review the amount of fees claimed by a liquidator.

If you are in any doubt about how the fees were calculated, ask the liquidator to set out the tasks undertaken and the time/cost for completing the tasks.

A Liquidator's costs and expenses (disbursements) has priority over his or her remuneration. Costs and expenses are those costs and expenses incurred by the Liquidator in undertaking his or her duties.

Remuneration hourly rates of a Liquidator are not limited (subject to being reasonable) for voluntary appointments, whereas for Court appointments the Liquidator is restricted to those hourly rates prescribed under the Act (Regulation 28) unless modified and accepted by the Court.

Liquidators costs and expenses and remuneration are payable in priority from the assets of the company. Liquidator's remuneration (although not generally disbursements) can be challenged through the Court pursuant to section 284 or section 301 of the Act by specified named parties who generally have a valid claim (or an accepted interest) in the liquidation.

Payment of dividends

If there are funds left over after payment of the costs of the liquidation, and payments to other priority creditors, including employees and the IRD, the liquidator will pay these funds to unsecured creditors as a dividend.

The priority of main creditor types is as follows:

1. costs and expenses of the liquidation, including liquidators' fees
2. outstanding employee wages and holiday pay
3. IRD – GST & PAYE
4. unsecured creditors.

Refer to the 7th Schedule of the Act for a full list of priorities.

Each category is paid in full before the next category is paid. If there are insufficient funds to pay a category in full, the available funds are paid on a pro rata basis (and the next category or categories will be paid nothing).

Proving your debt

Before any dividend is paid to you for your debt or claim, you will need to give the liquidator sufficient information to prove your debt. Refer s. 304 of the Act.

The liquidator will notify you if there are likely to be funds available for distribution and must call for formal proof of debt forms to be lodged. At least 14 days notice of the

deadline for lodging the claim must be given. This notice is usually included in the published notice of appointment.

You should attach copies of any relevant invoices or other supporting documents to the claim form, as your debt or claim may be rejected if there is insufficient evidence to support it.

The completed claim form must be delivered or posted to the liquidator. When submitting your claim, ask the liquidator to acknowledge receipt of your claim and advise if any further information is needed.

Other creditor rights

As well as the various rights involving meetings and participation in dividends discussed above, the other rights of unsecured creditors include the right to:

- receive written reports to creditors about the liquidation
- inspect certain books of the liquidator
- inform the liquidator about your knowledge of matters relevant to the affairs of the company in liquidation, and
- complain to the court about the liquidator's conduct in connection with their duties.

Liquidator's books

Liquidators must keep sufficient books to give a complete and correct record of their administration of the company's affairs. These include minutes of meetings and details of all the receipts and payments for the liquidation. These books must be available at the liquidator's office for inspection by creditors and shareholders.

Informing the liquidator

The liquidator must report if they suspect that anyone connected to the company may have committed an offence. If you have any information that might assist in preparing such a report, you should let the liquidator know so the liquidator can make a report to the relevant authorities, such as the Registrar of Companies or Financial Markets Authority. Offences under the Act are listed in s.373 and 374 of the Act.

Those authorities may review such reports and decide whether to take further action, such as banning a person from acting as a company director for a period of time or charging the person with a criminal offence.

Applications to the court

A liquidator, liquidation committee or, with the leave of the court, a creditor, director or shareholder can apply to the court if they are dissatisfied with an act, omission or decision of a liquidator. Refer s.284 and 286 of the Act.

This includes, but is not restricted to, requests that the court:

- give direction to the liquidator in a matter that has arisen
- challenge the liquidator's decision not to admit a claim form, either for voting or dividend purposes
- a review of the liquidator's fees, in certain circumstances
- confirm, reverse or modify a decision of the liquidator
- order an audit of the accounts of the liquidation
- declare whether a liquidator has been validly appointed

Making an application to the court can be costly. You should attempt to resolve any problems with the liquidator and only go to court if this fails.

Liquidators, and other people can also make applications to the court. For example, a liquidator might apply to have questions decided or powers exercised in a liquidation.

Secured creditors' rights

A liquidator will review loan and security documents for all secured creditors along with registrations on the Personal Property Security Register to ensure all secured claims are valid.

If a company fails to meet its obligations under a valid charge (e.g. General Security Agreement or "GSA"), a secured creditor can appoint an independent and suitably qualified person (a receiver) to take control of and realise some or all of the charged assets, in order to repay the secured creditor's debt. This right continues after the company goes into liquidation.

Another option available to a secured creditor is to ask the liquidator to deal with the secured assets for them and account to them for the proceeds and costs of collecting and selling those assets.

A secured creditor may;

- realise the property that is subject to their valid security, or
- value the property subject to their valid security and claim in the liquidation as an unsecured creditor for the balance due, if any, or

- surrender the security to the liquidator for the general benefit of creditors and claim in the liquidation as an unsecured creditor for their entire debt.

A secured creditor is entitled to vote at creditors' meetings for the amount the company owes them that exceeds the amount they are likely to receive from realisation of the secured assets. The secured creditor can participate in any dividend to unsecured creditors on a similar basis.

Refer to s.305 of the Act.

Directors and liquidation

Directors cannot use their powers after a liquidator has been appointed. They have an obligation to assist the liquidator by:

- advising the liquidator of the location of company property and delivering any such property in their possession to the liquidator
- providing the company's books and records to the liquidator
- advising the liquidator of the whereabouts of other company records
- providing a written report about the company's business, property and financial circumstances upon request from the liquidator
- meeting with, or reporting to, the liquidator to help them with their enquiries, as reasonably required, and
- if required by the liquidator, attending a creditors' meeting to provide information about the company and its business, property, affairs and financial circumstances.

A liquidator has the power to apply to the court to conduct a public examination, under oath, of a director (or other person with information about the company).

Refer to s.261 and 274 of the Act

Conclusion of liquidation

A liquidation effectively comes to an end when the liquidator has realised and distributed all the company's available property and made their Final Report to the Registrar of Companies. That Final report will include a request that the Registrar remove the company from the Register.

A company ceases to exist after it has been deregistered.

Important note: This information sheet contains a summary of basic information on the topic. It is not a substitute for legal advice. Some provisions of the law referred to may have important exceptions or qualifications. This document may not contain all of the information about the law or the exceptions and qualifications that are relevant to your circumstances. You will need a qualified professional adviser to take into account your particular circumstances and to tell you how the law applies to you.