Managing Corporate Insolvency

A Guide to the Compromise Regime

Introduction and Overview

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1 Introduction

As the beginning of the second decade of the 21st century is upon us the world confronts a financial and economic freeze of significant proportions. Our economic future depends upon the preservation of businesses many of which are in danger of a frozen death.

Part 14 and Part 15 of the Companies Act 1993 provide the means to save and rehabilitate companies in financial distress. Both constitute the compromise regime. **This Overview is to be read in conjunction with a Detailed Guide to implementation which is accompanied by documentary templates for the purpose.** **(See page 21 for instructions as to how to get copies of the Detailed Guide.)**

This Guide is intended to outline the nature of the Part 14 compromise regime and the steps that are necessary for its implementation. As part of this description it is necessary to consider the alternatives to compromise, particularly as an understanding of these alternatives sheds light on the advantages and disadvantages of compromise and the roles and responsibilities of directors.

2 History and background of the compromise regime

2.1 From inception to 1993

The company compromise is a venerable institution. It can be traced back to the Joint Stock Companies Arrangement Act, 1870. The provisions of that Act were very limited. It allowed a 'compromise or arrangement' to be proposed and approved by a Court when a company was in the process of being wound up. As such it had relevance only to certain sorts of businesses.

The typical application was in the circumstances where a company had creditors and related assets which could be compromised so that the core business could carry on in another entity. The archetypal example is a failed insurer. In such a case the creditor, being a policy holder, would be asked to reduce their entitlement to match the value of the assets held so that the business could be transferred to another insurer on terms that would be accepted by that solvent insurer.

The compromise mechanism is used to this day for the purpose of restructuring insurance operations. As will be seen in Part 2, this has made the regime appear more complex than is warranted. Insurance companies are complex – they can have a variety of different sorts of claimants such as trade creditors, creditors for unmatured policies, creditors for matured policies and so on. Much of the case law has been concerned to ensure that any one group of common interests is not advantaged to the detriment of another group.

New Zealand incorporated the compromise into its company law with subtle variation. The regime was expanded so as to allow a compromise to take place outside of formal winding up and it could be employed for varying shareholders' interests as well as creditors. It was still necessary, though, to apply to a court to have the proposal finally ratified.

2.2 The Companies Act 1993 reforms

The reform that produced the Companies Act 1993 introduced what is in effect a far-reaching variation on the compromise regime. Whilst it is permissible to seek court approval, it is not essential. It can be seen, therefore, that the subtle changes that have taken place since 1870 have produced in New Zealand an insolvency and business rehabilitation regime that achieves a balance between flexibility and formality.

The question arises as to why the use of the regime is not more common. When considering the reforms that led to the introduction of Voluntary Administration, the New Zealand Law Commission considered the use to which compromise had been put. Its paper, *Insolvency Law Reform: Promoting Trust & Confidence* [Study Paper 11 2001] on the subject reported on field research thus:

> Parts XIV and XV of the Companies Act 1993 were "grossly under-utilised"; an educational issue was raised in relation to some creditors, that is that they tended to

focus on the benefits to shareholders or directors from the use of those procedures rather than on the potential benefit to the creditor by way of distribution if the economic value of the business was preserved. An educational issue was also raised with regard to the managers of insolvent companies. [Paragraph 197]

It is the author's experience that creditors confronting a proposal for compromise are not as cynical as this might suggest. Even through the economic booms of the 21st century, businesses are accustomed to debtor collapse with no prospect of repayment. When presented with the opportunity to recover something, creditors put aside their irritation and respond positively.

The problem really lies in the last comment in the quotation above. The problem with compromise is a matter of awareness.

3 The compromise regime – an outline

In posing the question to himself in the matter of *In re Alabama, New Orleans, Texas & Pacific Junction Railway Company* [1890] 'What is a compromise?' Justice North answered: 'An arrangement by which they both make concessions and give up something.'

A compromise is simply that. An insolvent company makes a formal proposal to its creditors to extend forbearance either by extending the duration of their claim, reducing the amount of the claim, changing its nature or a combination of all three. In exchange the creditors are entitled to information about the company that may not otherwise be available and will be entitled to a say in the running of the company.

The mechanics of compromise are set out in three sections of the Companies Act 1993.

Section 228 entitles a range of persons (the proponents), for instance the directors, to propose a compromise when those persons believe the company is or will be unable to pay its debts.

Section 229 sets out the requirements of the formal proposal:

- The proponent must call a meeting of creditors.
- Information about the nature of the proposal, the reasons for it and the consequences for the creditors.

The proposal document must be sent to the Registrar of Companies as well as the creditors. Section 229 does not specifically require that financial information is provided. However, it is difficult to see how the requirement to explain the reasons for the compromise and its consequences if such information is not integral to the proposal documentation.

Section 230 sets out the procedure for approving the compromise. There are three important features of the approval basis. Firstly, the proposal has to be approved by a 75% majority. Second, if there are differing classes of creditor, the majority has to be within each class. Thirdly, the decision of the majority is imposed on the minority.

If there is a flaw in the compromise regime it is the ambiguity in regard to what constitutes a class of creditor. As noted, this question has a long-standing legal history and this will be considered in detail in Part 2. There are clear cut examples of class distinction. For instance, a secured creditor differs from an unsecured creditor. The trouble comes when a dissenter from the minority attempts to demonstrate that they were a separate class from the outset.

Fortunately, recent case law has begun the process of minimising the fragmentation of creditors into separate classes that began in the Victorian age. In essence, however, the secret to effective compromise is good faith. Fragmentation arises when creditors believe they are being disadvantaged. Much of this perception can be defused if the proponent is open and honest. It is the author's experience that creditors respond favourably even when confronted with bad news if they are made aware that they are empowered by the proposed compromise process.

The Companies Act allows for, but does not require, access to the Courts to give directions in relation to or approvals of compromises.

4 Recent developments

4.1 Introduction

Over recent years there have been three developments of importance to the compromise regime:

- A seminal New Zealand case which has clarified how to undertake compromise.
- The spectre of occupational licensing in the practice of insolvency.
- The business debt rehabilitation regime.

4.2 A seminal case

In 2013 litigation took place which resulted in the judgment of *Bank of Tokyo-Mitsubishi UFJ Limited v Solid Energy* CIV-2013-404-4413 [2013] NZHC 3458. The circumstances are likely to be unique but, nonetheless, the matter clarified important principle in three areas of implementing compromise.

The background facts are these. Solid Energy became financially embarrassed. It had borrowings from various banks in various ways. Most of the banks wanted to restructure the affairs of Solid Energy so as to take preference shares instead of debt. Bank of Tokyo resisted. Taking advantage of the 'cram down' facility within compromise, Solid Energy initiated a compromise which had the effect of imposing the proposed restructure on Bank of Tokyo as the dissenting minority. Bank of Tokyo challenged the compromise.

Bank of Tokyo claimed that the terms of the compromise were outside the scope of Part 14 in the proposal to swap debt for equity. Justice Winkelmann confirmed that terms involving exchanging debt for equity was permissible. This is, perhaps, the most important finding.

Bank of Tokyo claimed that the wrong basis for insolvency determination – a necessary step in the lead up to compromise – was used. Justice Winkelmann confirmed that the distinction between a balance sheet insolvency measure and a liquidity measure was more apparent than real.

Bank of Tokyo claimed that all known creditors needed to be notified. The judgment disagreed. It is only those creditors whose rights are to be disturbed that need to be notified.

Whilst it is a little oblique, the case can be read to say that the determining criterion for inclusion in any class is what would happen in the 'counter-factual', being liquidation. If the position amongst the creditors is much the same upon dissolution, they are in the one class for voting.

4.3 Occupational licensing

The original premise of this Guide was that the people best placed to assist financially troubled companies were their general practitioner accountants. The basic proposition being that dealing with rehabilitation in insolvency is a core skill of the accountant, particularly as client specific and industry knowledge is valuable if a company is to be rescued.

An occupational licensing regime was introduced in the form of the Insolvency Practitioners Regulation Act 2019 (IPR Act). The IPR Act only allows licensed persons to carry out insolvency work. An insolvency practitioner is defined, with respect to companies, as being a person carrying out administration, (insolvent) liquidation and receivership. It would follow that a professional assisting with compromise does not fall within its scope. However, Chartered Accountants would need to be cognisant of IES 1 *Insolvency Engagements* which is wider in scope.

The effective date for the IPR Act to take effect was to be mid-June 2020 with a period of grace of one year after that. However, it has been postponed to June 2021 with the proviso that it might be sooner. CAANZ advice is that it will be September 2020.

4.3 Business Debt Hibernation Scheme

On 15 May 2020 the Covid-19 Response (Further Management Measures) Legislation Act 2020, amending the Companies Act, took effect. It introduced the Business Debt Hibernation (BDH) scheme. The provisions relating to that scheme occupy 40 pages of the amending Act. If a company qualifies to enter the regime it enables some, but not all, creditors to agree to have a stay imposed on their ability to enforce. The relief is temporary. Creditors who are excluded include general security holders, employees and the Crown for certain debts. The amending Act also grants relief from certain directorial duties such as reckless trading.

The qualifications to enter the BDH scheme and its subsequent operation are onerous as is evident, perhaps, in the length of the law governing it. A good example is the certificate that assenting directors have to sign, which certificate is very public. It requires the directors to certify that:

- The company was able to pay its debts (liquidity solvency) at 31 December 2019.
- The director is acting in good faith.
- The liquidity problems being experienced are due to Covid-19.
- The company is more likely than not to be able to pay its due debts at a later date.

A director would need to be very wary about making formal assertions on these grounds. Determining liquidity solvency, even retrospectively, is replete with conceptual difficulties. The question of Covid-19 as the cause of financial difficulty is problematic in that its effect would have to be disentangled from other factors. Then there is the matter of future liquidity. Any director making such assertions would need to have a systematic and realistic cash flow forecast available before so certifying.

The BDH scheme is mutually exclusive of compromise. As the directors need to admit illiquidity anyway, they might as well just default to compromise which gives permanent relief.

5 General obligations of directors

The obligations of directors are set out by Justice Baragwanath in two important cases.

In *CIR v Chester Trustee Services Limited* [2003] 1 NZLR 395, 405-6 he wrote:

> The very purpose of the legislation creating a legal entity distinct from its directors and shareholders is to allow it to engage in business activities entailing risk without exposing shareholders to greater liability than the amount of their investment. The condition of the privilege is that the company be able to pay its due debts. Inability to pay debts triggers a series of consequences.

This guide will consider these consequences in detail in 3.3 below. Suffice to say that the consequences involve personal financial responsibility being imposed on directors and the voidance of certain transactions.

Justice Baragwanath went on to elaborate upon this theme in *Mountford v Tasman Pacific Airlines of NZ Limited* [2005] 9 NZCLC 263,864 where he wrote:

> I am satisfied that the "general obligation [under former legislation] to maintain the company's capital" recorded by Richardson J in *Nicholson v Permakraft* at p 255 has now been superseded by what may be expressed as a general albeit imperfect obligation not to trade while insolvent, which is to be inferred from the whole scheme of the Act. The obligation to maintain solvency could not be absolute, because that would destroy the very justification for limited liability which requires the protection of directors who, acting reasonably and in good faith, are unable to prevent the failure that is both a regular fact of business life and the justification for limited liability. The obligation is imperfect because breach does not, per se, attract legal consequences for the directors. But it is nevertheless an obligation because it is the premise on which there is unconditional entitlement to continue to trade.

This theme recurs in a number of judgements in regard to the Companies Act 1993. There is not an obligation to desist from trading the moment insolvency is imminent. Rather the obligation is to begin to focus on the interests of the creditors.

Clearly if the interests of creditors are best served by stopping trade immediately, then that is what will be expected of the responsible director. However, it is rarely the case that an abrupt halt is in anyone's interest. Almost all assets, other than cash or equivalent, are affected by disposal in haste or in a fire sale. Such assets are better to be realised either over a normal trading period (e.g. on a willing buyer willing seller basis) or by generating income from them. That being the case, the responsible director will balance his or her view of the maximum return by continuing in trade against the consequences of immediate realisation.

Interests of creditors may extend beyond the immediate sums of money owed to them. For instance, employees' wider interests are invariably served, particularly in the current climate, by the preservation of their jobs. Similarly, suppliers' interests are served by a continuing supply opportunity. Some caution may need to be adopted here. It might be valid to incur more credit from Person A, a continuing supplier, because it is in their wider interest. But it certainly would not be to take credit from Person B who would be making a 'one-off' supply.

In such circumstances the director needs to pose the question to him or herself: what would the potential supplier do if they were fully apprised of the facts?

Alternatively, the director could give them the facts and have them make their own decisions. This is not a tradition in New Zealand as it is, for instance, in the United Kingdom. However, in this regard it is interesting to note that an attempt to hold a director personally responsible was thwarted in a case partly because the plaintiff had access to the company's records (*Re Petros Developments Limited*: *Advanced Plastics Limited v Harnett* CRI 2003-404-0633).

As is evident from the discussion above, one of the central features of the compromise regime is disclosure.

6 Alternative insolvency regimes

6.1 Introduction

In order to appreciate the merits of compromise it is necessary first to consider the alternatives. As is evident from the discussion on directors' responsibilities one of the options when confronting imminent or actual insolvency – do nothing – is not considered viable. Accordingly, the options are:

- Receivership.
- Liquidation.
- Voluntary administration.
- Informal arrangements.

6.2 Receivership

It is stretching a point to describe receivership as being an option available to the directors. The media is fond of referring to the act of "calling in the receivers". However, it is much more likely that the receiver is imposed rather than voluntarily asked for.

A receiver is a person who takes control of specific property where that property is subject to an agreement that confers on a creditor a right to the property in certain circumstances. Insolvency will be one such event.

A receiver may be appointed in accordance with a specific right, such as a mortgage or some form of retention of title (now a 'purchased money security interest' or PMSI) or, more generally, in accordance with a right conferred by a general security agreement. The receiver will take control of the business either because the secured property is so central to the conduct of the company's business that it cannot be conducted without it or because there is a general right to the entire undertaking. Frequently, the secured creditor will have specific and general rights. Bank loans are often so secured.

Personal property security law and receivership are relevant to the compromise regime only in so far as the matter of secured creditors needs to be considered and handled carefully.

A receiver must be an outsider (see section 5 of the Receivership Act 1993) and will invariably be a professional insolvency exponent with commensurate cost.

6.3 Liquidation

6.3.1 Introduction

The subject matter of the topic of liquidation is too broad to be covered in this Guide. The purpose of considering some issues that arise in liquidation is to present a contrast between liquidation and the compromise regime.

6.3.2 The liquidator and their duties

It needs first be noted that a liquidator must be an outsider (see section 280 of the Companies Act 1993). Again, this is likely to be a professional.

The primary duty of a liquidator is to collect and realise the assets and pay the proceeds to creditors (section 253 of the Companies Act 1993). In practice this is an expensive process for two reasons. First, a professional and his or her costs, including legal advice, have to be paid. Second, the fire sale phenomenon is likely to prevail, meaning that assets are disposed of at low prices.

It is not legally inevitable that liquidation ends in the final death and interment of a company. For example, a liquidator can be the author of a compromise. Practically such a step is unlikely as it entails legal complexity and risks for a liquidator that would be prohibitive. There is provision for a business to survive if not the company in liquidation courtesy of the (legitimate) 'hive down' procedure set out in section 386D of the Companies Act 1993.

One of the ambiguities in the conduct of liquidation is the extent to which section 253 of the Companies Act 1993 obliges the liquidator to 'realise' assets that remain incomplete.

Such assets are those that require court action. Though there has been relatively recent legislative change to reduce the effect, there is a flaw in the liquidation regime. It has been very easy for directors of closely held companies to appoint a liquidator who remains tame in respect to those directors. The possibility of action against directors was largely theoretical in such circumstances.

Policy makers have been aware of the complaisant liquidator problem and steps have been taken to reduce the problem (see discussion of occupational licensing at 4.3 above). Also, creditors dissatisfied with such conduct and can force a change of liquidator or take direct action. It is also to be noted that the Companies Act was changed to make it clear that liquidators were entitled to sell legal actions (section 260A). All of this makes it more important for directors to consider the consequences of liquidation.

6.3.3 Remedies for breaches of duty

There is little need to provide detail on the specific duties of directors as these are well known. Suffice to say that directors are not allowed to endanger creditors by being reckless, acting in bad faith or not exercising a proper duty of care (see sections 131 to 138 of the Companies Act 1993). A liquidator can, and in the opinion of some, must sue for breaches of these duties.

Importantly, the Companies Act 1993 entitles a creditor to sue for breaches of these duties after the initiation of liquidation.

There is a directorial duty under section 194 to maintain proper accounting records. The right to sue in regard to this duty is to the sole right of a liquidator (see section 300 of the Companies Act 1993). In this regard the passage cited from *Chester Trustees* should serve as severe warning. It continues by saying that one of the consequences of an inability to pay debts is 'being presumptively deemed to have failed to keep proper accounting records'. It is noteworthy that section 194 was altered with effect from 2013 so as remove reference to the Financial Reporting Act 1993. However, the core responsibility – to correctly record and explain transactions – was kept and, importantly, the requirement to have systems of controls was added. Directors should be vary wary of this provision.

Even those directors covered by directors' and officers' insurance need to be careful of breaches of duty. A breach of duty can be the basis for a banning by a Court of the right to act as director (see section 385 of the Companies Act 1993). Even more seriously, there is often a fine line between recklessness and being fraudulent (section 380 of the Companies Act 1993). Directors need to be very careful, particularly as it is a duty of the liquidator to report crimes (see section 258A of the Companies Act 1993).

It is the means by which these potential consequences are avoided that needs to be upper most in the director's mind when he or she contemplates company insolvency.

6.3.4 Remedies for unfair preference

The Companies Act 1993 gives liquidators has remedies in cases where one person has been favoured at the expense of the other creditors, including:

- Voiding transactions having preferential effect (section 292).
- Voiding unfair grants of security (sections 293 and 299).
- Compensation for transactions at other than market prices (sections 297 and 298).

Of these the most common is the claw back of monies paid to creditors in the lead up to the liquidation. In the context of the compromise regime one of the most important features of the voidable preference remedies is that they are time sensitive. This is for two reasons.

First, there are time limits, measured from the point of liquidation, applicable to this class of remedy. Second, a defence against a voidable preference claim is that the recipient of money has ordered their affairs in anticipation of keeping it. In either case the more that liquidation is prolonged, the more likely these remedies will be ineffective.

This is an important consideration for some in the consideration of compromise. For instance, those subject to a preference on liquidation, all other things being equal, ought to be careful about erosion of potential recoveries as liquidation is forestalled.

6.3.5 Other remedies

A company has a number of rights under the Companies Act 1993 that fall into the hands of a liquidator upon liquidation. These include recoveries of invalid distribution (section 56) and directors' salaries (section 161). These may even include the voidance of transactions in which a director has an interest (section 141).

It is more likely that these remedies are triggered by a liquidator than they would be by a director. However, these are factors that a director should contemplate when attempting to save the business he or she is operating through the company.

6.3.6 Liquidation and compromise: a contrast

Liquidation can be highly traumatic and disruptive. Liquidation can be destructive of value of assets, particularly intangible assets such as goodwill.

Liquidation has the potential to disturb settled transactions creating significant uncertainty. Compromise forestalls these potential consequences, albeit to the potential detriment of some.

Liquidation can render directors accountable for failure to attend to creditor interests. Compromise is one way of ensuring that the director is seen to act in good faith and in the best interest of the company, which upon insolvency, equates with the interests of the creditors.

6.4 Voluntary administration

Voluntary administration (VA) is a relatively recent addition to the methods for dealing with insolvency in New Zealand. It is a form of business rehabilitation, as is the compromise regime. However, it is considerably more formal and administratively complex than compromise. For instance, it occupies 65 pages of the Companies Act compared to a mere 7 for compromise. Complexity and formality add expense.

In addition to complexity and formality two features of the VA regime distinguish it from compromise:

- It is necessary for the formal appointment of an administrator.

- Creditors' claims can be stayed for a period.

In the case of a large enterprise these features are probably necessary for the successful conduct of business rehabilitation. In other words, the dead weight expense of professional cost is justified.

VA does entail the so-called 'cram down' capacity in which a super-majority of creditors can impose their view on the minority of creditors in votes in the various meetings that need to take place. This does not distinguish VA from the compromise regime as it too has this capacity.

There is a less than benign aspect of the VA regime that is evident here and in Australia, on whose regime the structure of ours has been based. VA can lend itself to manipulation in a similar way that liquidation can be misused. This arises from a combination of the use of professional insolvency exponents and complexity. Both these features make it difficult for a single creditor to challenge. As the compromise regime relies upon co-operation and transparency, the potential for abuse is minimised.

6.5 Informal and bilateral arrangements

An informal or bilateral arrangement is regarded here as encompassing those business rehabilitation or debt remission efforts that happen outside of a formal regime defined within business law (Companies Act, Receivership Act and so on). Most often they will occur in the context of contract law such as subsists between a company and, principally, its bank. It may, however, take place in the context of statutory provision such as prevails in the case of the Tax Administration Act 1994.

An informal arrangement is generally a bilateral arrangement between a debtor and its creditor. Unless there is a complete set of bilateral arrangements, the risk to an informal arrangement is that any other creditor may take alternative enforcement action and disturb the bilateral arrangement to which that creditor is not a party.

The compromise regime has the multi-lateral character of VA which enables it to overcome the deficiency of informal arrangements.

7 Compromise: advantages and disadvantages

7.1 Introduction

The advantages and disadvantages of compromise depend, to some extent, upon one's perspective. An advantage to a company's director, for instance, may be a distinct disadvantage to a creditor.

7.2 Principal advantage

There is one unambiguous advantage to all – the company subject to compromise has a far better chance of survival. From this spring two specific advantages.

Assets subject to immediate realisation invariably fetch less than if realised in the ordinary course of business. This is true of stock and certain financial assets such as receivables – it being an unfortunate phenomenon that debtors find ways to frustrate liquidators in the course of collection. Capital assets are particularly vulnerable to destruction of value in fire sale. Even more vulnerable are intangible assets such as goodwill which depend upon continuing business to have any value.

The second advantage is that suppliers and employees have a continuing business operation to which to sell their wares. Liquidation does not guarantee destruction of the continuing business, but the risk is significantly heightened.

It is the belief of the author that the advantage of 'going concern' in most circumstances will outweigh the disadvantages to all parties.

7.3 Flexibility and ease of operation

Another important advantage of compromise is its flexibility and ease of operation. A compromise can be managed by the directors of a company.

All other formal mechanisms for dealing with insolvency necessitate the involvement of company outsiders. This generally entails dead weight cost which struggling small to medium sized companies have difficulty bearing.

The disadvantage of the absence of formal structure as applies, for instance, to VA, is that uncertainty can arise. This may provide fertile ground for the growth of dissent that leads to creditor fragmentation.

Compromise even has the capacity for on-going flexibility. Provided that the proposal is so configured, variation can be introduced after the creditors meeting.

7.4 Compromises are multilateral

A very important advantage of compromise is that it can bind all creditors in the event a super-majority agrees the proposal. No dissentient creditor can therefore disturb that which is perceived by the majority as being in its interest.

7.5 Transparency

It is as well for directors and shareholders of closely held companies to realise that the price to be paid for a successful compromise is that the affairs of the company and its business are open to view to a range of persons who may not otherwise have access. Some would perceive this to be a disadvantage, particularly where the company has been operated on an insolvent basis for some time.

The need for transparency, particularly financial transparency, certainly will act as an inhibiting factor in the widespread use of compromise. Financial secrecy in the affairs of the closely held company is valued at a premium. There is an element of the irrational in this attitude. Creditors have provided resources to the insolvent company. There is little justification for asserting that they should have done so on faith.

Yet acting on faith alone is routinely done, or at least it is done by those making up the lower caste which constitutes the credit-giving caste system that prevails in New Zealand. Members of the strong caste, headed by banks, never do act on faith alone. In making the case for transparency in a wider context, the role of the opaque in the affairs of hedge funds and unaccountable insurers in the last financial collapse should not be under-estimated. Perhaps an important element of recovery is for a fundamental change in mind set, starting with the insolvent or near insolvent closely held company.

7.6 Avoidance of the consequences of liquidation

Compromise mitigates the consequences of liquidation in two ways, one benign and the other not so benign.

Directors can reduce their culpability for the consequences of corporate failure by initiating a compromise on a timely basis.

Less benignly from the point of view of creditors, some of the liquidation specific remedies are deferred and, in some cases such a voidable preference, extinguished. This is advantageous to some but not to others. Some care needs to be taken here. If there are blatant abuses in regard to unfair preference and the compromise has been used as a stratagem to erode the potential for claw back, then the disadvantaged creditor will have grounds for asserting they belong in a different class with the complication that entails.

At first sight it may appear that a director can forestall the potential for suit against him or her for breaches of duty. This is because the Companies Act reserves the right to trigger the remedies available for breaches of duty to after the liquidation has begun. However, lawyers would claim that the codification of common law duties did not negate those duties. Such duties may be parallel but not fettered by the legal state into which the company has fallen or otherwise. In other words, a director should not consider themselves immune because the have forestalled liquidation by the use of compromise.

7.7 Statutory demands

It is worth noting that section 289 of the Companies Act 1993, which describes the statutory demand process, specifically requires a claimant creditor to invite compromise. It is highly desirable for directors of companies receiving such demands to act accordingly. It seems to the author that attempting to invoke liquidation stands a good chance of foundering if the creditor is seen to merely be paying lip service.

8 Four propositions

This guide is underpinned by four basic propositions.

Proposition 1

Creditor cynicism can be minimised by transparency and honesty. As compromise only works in a spirit of co-operation in which substantial creditor support is necessary, it is difficult to employ the regime to the detriment of creditors. Shareholder and director interest need not be in opposition to creditor interest.

Proposition 2

Compromise is viable even if the return to creditors is only 1c in the dollar greater than would be achieved upon dissolution.

Proposition 3

Even the effort required to give effect to compromise is, and will be seen to be, an attendance on the interests of creditors when a company is insolvent. The process can be built upon to take an alternative course of action. In this way damage can be reduced and directorial exposure mitigated.

Proposition 4

Any good businessman or woman with a modicum of technical input from lawyers and accountants should be able to co-ordinate a compromise with the minimum of fuss and expense.

Further materials

In addition to the Guide as described the author has prepared a series of videos which appear on Facebook and YouTube under the rubric 'Managing Insolvency in Trouble Times'.

The Detailed Guide to compromise and its related documentary templates is available by sending an email or other correspondence to:

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Facebook page:

https://www.facebook.com/robertbwalkercapage/

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