



GUIDE TO INSOLVENCY AND BANKRUPTCY

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CONTENTS

Introduction.....	2
The Application of the Law - Comparisons	3
Options available to you.....	3
The Role of the Official Assignee.....	4
Petitioning for bankruptcy.....	5
General Aspects of Bankruptcy.....	5
Travel and credit ratings.....	8
Proof of debt.....	8
summary of restrictions during the bankruptcy term.....	8
No Asset Procedure	9
New Zealand Insolvency and Trustee Service offices.....	10
How we can help you	11

INTRODUCTION

Personal insolvency and definitions

Insolvency is the inability to pay one's debts as they fall due. Bankruptcy, on the other hand, is the formal status resulting from an adjudication of a person (as opposed to a company) as a bankrupt. Insolvency is a ground for bankruptcy, but not every insolvent person is bankrupt. Bankruptcy involves formal proceedings in the High Court where a debtor who has committed certain acts is divested of his or her property. That property is vested in an officer of the Court titled the "Official Assignee" who distributes the bankrupt's assets amongst creditors according to statutory priority. For a variety of reasons a creditor may elect not to bring bankruptcy proceedings against an insolvent debtor. Often the time and expense involved is not justified because of the amount of the likely recovery from the bankrupt's estate.

Methods of becoming bankrupt

Bankruptcy occurs in the High Court either upon your own action or the action of one of your creditors. As a debtor you may voluntarily file a "Debtors Petition" for bankruptcy when you are unable to pay your debts as they fall due and your financial position is irreversible. A fee will be charged for the filing of the Debtor's Petition and this will be deducted from any asset realisations made. Alternatively, one of your creditors may apply to the High Court which then decides whether you should be made bankrupt on the evidence supplied by the creditor and by yourself, or your representative.

No asset procedure

This is a procedure for dealing with a debtor who has no realisable assets.

Corporate insolvency

Bankruptcy applies to natural persons only. In the case of a company being unable to pay its debts the choices include total liquidation. Alternatively a creditor who has power to do so, may appoint a receiver to take control and dispose of the assets of the Company to secure the repayment of any creditors debt. Not every creditor has security against the assets of a company, and not every secured creditor has the right to appoint a receiver. The power to appoint a receiver is usually conferred under a debenture which is the security document containing the terms of a loan to the company and defining the assets which secure the loan. The appointment of a receiver to a company is not terminal. In some cases the company may trade out of receivership under the direction of the receiver. However, liquidation usually follows.

A company may reach an accommodation with its creditors where it pays each a proportion of the debt in full settlement. Creditors may choose this option where recovery is likely to be greater under such a compromise arrangement rather than in the liquidation of the company. There is a provision in the Companies Act 1993 which allows a compromise to be entered between the company and the majority of creditors whose vote, if it reaches 75% of the proportion of the debt owing, it is binding on all creditors.

THE APPLICATION OF THE LAW - COMPARISONS

Bankruptcy is different today from how it was portrayed by Dickens. The days of debtors prisons as punishment for non payment of debt are long past.

People who face bankruptcy are mainly the wreckage of storms that routinely assault the world of business where the edge between profits and irrecoverable losses can be exceedingly thin. The majority of bankrupts become unstuck through misjudgement, misfortune or blind optimism. Bankrupts are often victims of circumstances beyond their control, but not often dishonest. Indeed the Official Assignee's office will tell you that fifty five percent of bankruptcies have "*no taint of dishonesty*". A further thirty percent or so run their business ineptly, the remaining fifteen percent either resort to illegalities when business turns sour, or embark on them from day one.

In its essentials, the Insolvency Act 2006 says that bankrupts - that is those who cannot meet their creditors' demands - must work out some sort of limbo period of three years before they can get back into business. After that, whether paid or not, creditors have no further claim on them. The slate is wiped clean unless the Official Assignee applies to extend the bankruptcy order.

The Insolvency Act 2006 blocks a bankrupt from sheltering assets in a spouse's or defacto partner's name for clearly fraudulent purposes. It allows the bankrupt to retain "*necessary household furniture and effects*" including "*wearing apparel*", of themselves and their family but only to the total value of \$2,000.00. A bankrupt can also keep his/her tools of trade to the value of \$500.00.

OPTIONS AVAILABLE TO YOU

If you are thinking about declaring yourself bankrupt you may wish to consider the following as an alternative to bankruptcy:

Sale of assets

Your present financial difficulties may be solved by selling some of your assets. The more common methods of selling your assets are to advertise in the local paper, to have a garage sale, or to sell at an auction.

Reducing your financial commitments

You should look realistically at your situation and see if there is any expenditure which you can reduce or eliminate. For example, you may be able to return non-essential goods under hire purchase which you cannot afford.

Budgeting

This is a means of equating your income with your outgoings. A budget advisory service, an accountant, a solicitor or some welfare organisations can help you with this.

Creditors' pool

This is where all of your creditors agree to receive payment in reduction of the debt by way of regular instalments. A creditors' pool can be run by a budget advisory service, an accountant or a solicitor.

Refinancing

You can refinance with the assistance of advisers, for example, your bank manager, accountant, solicitor or lending institutions.

Compromise with creditors

This is where you can reach some form of agreement with your creditors with respect to paying a proportion of the debt in full settlement. Advice on this procedure can be obtained from your accountant or solicitor.

Summary instalment order

This is an order made by a District Court Judge, which allows a person in debt to pay back those debts in regular easy stages without the threat of further legal action while the order is in force. A supervisor can be appointed to help you budget for repayment. Details are available at your nearest District Court. However, your debts must not exceed \$40,000.00.

Continue trading

If you are only temporarily insolvent and operate a business, it may be possible for you to trade your way out of financial difficulties. It is recommended that professional guidance be obtained if this option is considered.

Bankruptcy

This occurs either through your own action or through legal action taken by one of your creditors. Before arriving at any decision to make yourself bankrupt, you should consider discussing your financial situation with your accountant, solicitor or other professional advisor.

THE ROLE OF THE OFFICIAL ASSIGNEE

As an officer of the High Court and under the powers vested by the Insolvency Act 2006, the Official Assignee's function is to administer equitably and independently the affairs of people who become bankrupt.

Under the Official Assignee's guidance as trustee, the assets within each bankrupt estate are sold and the proceeds fairly distributed amongst the creditors.

Apart from giving the bankrupt relief from the burden of debts, the Official Assignee may also provide for the bankrupt's rehabilitation if the circumstances are appropriate.

The Official Assignee may also investigate a bankrupt's past financial affairs and take action to prosecute the bankrupt for offences when it is considered to be in the public interest or there has been a blatant disregard of insolvency law.

The Official Assignee may also make allowances of money for the support of the bankrupt, which represents a total departure from the old retributive attitudes of the past.

The law places a comprehensive obligation on the bankrupt to hand over all assets and details of them and to provide all information about expenditure, sources of income and other forms of revenue which might be seized by the creditors.

The prohibition against the bankrupt getting involved in business inside a three year period is exceedingly strict. Without official permission, the bankrupt must not enter into, carry on, or take part in, the management or control of any business.

PETITIONING FOR BANKRUPTCY

An overview of the bankruptcy procedure reveals the ability to petition a court to make someone bankrupt. The petitioning creditor must appear at the hearing and immediately upon adjudication, the Official Assignee becomes entitled to all property of the bankrupt person. The doctrine of relation back entitles the Official Assignee to all property belonging to the bankrupt from the commencement of the bankruptcy at the date of adjudication. Accordingly the Official Assignee can upset transactions between the bankrupt and third parties which occurred between the commencement of the bankruptcy and the date of the adjudication. The period of relation back runs from the date of the first act of bankruptcy committed within three months before the filing of the petition. On adjudication there are restrictions on the bankrupt leaving New Zealand without the consent of the Official Assignee. The bankrupt's obligations include the handing over of all debts and liabilities. A meeting of creditors summarises the bankrupts financial situation.

GENERAL ASPECTS OF BANKRUPTCY

Assets

All your assets subject to the following exceptions automatically become the property of the Official Assignee. The exceptions are:

- Furniture and personal effects – the maximum value is fixed at the Assignee's discretion;
- Motor vehicle - \$5,000.00;
- If you are a trades person, tools of the trade – the maximum value is fixed at the Official Assignee's discretion;
- Money up to a maximum of \$1,000.00.

Usually you will be able to retain these assets, however all situations are subject to the Official Assignee's discretion.

Debts

The Official Assignee becomes responsible for most of your liabilities incurred up to the date of your bankruptcy. You must not pay these creditors directly. You are still however, personally responsible for:

- Fines imposed by the Court;
- Maintenance and child support payments;
- Any orders for reparation made by a Court;
- All debts incurred after the date of your bankruptcy;
- Certain outstanding Work and Income New Zealand debt.

Initial Interview

As soon as you become bankrupt you may be requested to attend an interview at an office of the New Zealand Insolvency and Trustee Service. At this interview you will be asked to complete forms which will supply the Official Assignee with the background to your bankruptcy.

Notice to Bankrupt

Once you become bankrupt you are forwarded a notice which can be shown to creditors as evidence of your bankruptcy.

Advertisement

After you become bankrupt, a notice advertising your bankruptcy will be published in the regional newspapers where you live and where the majority of your creditors are, and also in the New Zealand Gazette.

House inspection

A house inspection may be conducted in order to assess whether you have any saleable assets to help pay your creditors and what household effects or other possessions you reasonably need to carry on living.

Creditors' meeting

A meeting may be held to give an opportunity for the Official Assignee and creditors to ascertain the cause of your bankruptcy and to allow examination of any matters that arise. You will be put under oath for any questioning.

The Official Assignee will give a report to creditors about your bankruptcy.

House property

Your interest in a house property is an asset in your bankruptcy subject to existing securities, e.g. mortgages. The Official Assignee will only take steps to sell your property if a valuation reveals that there will clearly be a surplus available after the mortgage(s) have been repaid.

If your property is registered under the Joint Family Homes Act 1964, there is a specified sum which is not available to the Official Assignee in the event you become bankrupt. This sum is presently \$103,000.00. A Joint Family Homes registration is valid if it has been in existence for two years or if it has been advertised after three months.

Vehicles

The decision whether you retain your motor vehicle will be made by the Official Assignee. Factors considered by the Official Assignee include the value of the motor vehicle and your personal circumstances. Motor vehicles more than \$5,000.00 are likely to be sold.

Hire purchase and secured creditors

Usually payments for items on hire purchase or subject to a security are still your responsibility. However, if their value exceeds the amount owing to the financier the Official Assignee may decide to sell the items, repay the financier and apply the surplus to your bankruptcy. If the items have been repossessed and if money is still owed to the financier, then the debt is included in your bankruptcy.

Life insurance

All policies you own and/or are entitled to receive the benefit of, become the property of the Official Assignee and may be surrendered for the benefit of your creditors.

Superannuation schemes

Superannuation policies which have a surrender value may be included in your bankruptcy.

Money due to bankrupt

Any money owed to you is an asset which vests in the Official Assignee and any documentation of the debt must be provided to the Official Assignee who will attempt to recover it.

Legal action for recovery of debts

Once you become bankrupt, creditors are usually prohibited from continuing or commencing any action to recover money owing.

Contributions

If you have paid employment you may be required to complete a budget form which will be used to assess your ability to make regular payments to the Official Assignee.

The Official Assignee will not ask for contributions if your only income is a welfare benefit. If your financial circumstances change, you must advise the Official Assignee immediately so that a fresh assessment can be made of your circumstances. Earnings by a non-bankrupt spouse/partner do not pass to the Official Assignee.

Discharge

Usually you will be automatically discharged three years after filing a statement of affairs. However, you may apply to the High Court for a discharge at an earlier time.

In some instances the Official Assignee or a creditor may either object to a discharge or seek a conditional discharge such as obtaining an order prohibiting you from entering into business.

TRAVEL AND CREDIT RATINGS

It should be noted that a bankrupt does have the power to leave the country with the consent of the Official Assignee. From a practical point of view the fact that someone has been made bankrupt at some stage of their life will reflect on their credit rating for future credit purposes. A downside to a bankruptcy can be the difficulty to obtain credit to buy housing in the future.

The powers of the Official Assignee include general powers, powers of sale, power to carry on the business of the bankrupt and the power to make payment for services rendered before adjudication. Anyone contemplating bankruptcy should seek advice about the ability of the Official Assignee to look back into the financial transactions of that person two years prior to the first act of bankruptcy. They should also seek advice about voidable dispositions made by people prior to their bankruptcy. Voidable gifts include any gift of property as against the Assignee, if the donor is adjudged bankrupt within two years of making the gift.

PROOF OF DEBT

Those people owed monies by a bankrupt go through a proof of debt procedure administered by the Official Assignee's office. All provable debts are collated and secured creditors taken into account, prior to the distribution of the bankrupts assets by the Official Assignee.

SUMMARY OF RESTRICTIONS DURING THE BANKRUPTCY TERM

The following are duties imposed upon you under the Insolvency Act 2006. You are required to:

- Co-operate fully with the Official Assignee at all times and comply with all requests for information;
- Notify the Official Assignee whenever you change your name, address, employment or terms of employment, income and/or expenditure;
- Fulfil any other duty imposed on you by the Insolvency Act 2006.

You are not permitted to:

- Be a director of a limited liability company, self-employed, start a business or go into partnership;
- Take part in the management or control of any business or company without the consent of the Official Assignee;
- Be employed by a relative or entity owned, managed or controlled by a relative without the Official Assignee's consent;
- Leave New Zealand without first obtaining consent of the Official Assignee;
- Withhold information sought by the Official Assignee or mislead the Official Assignee;
- Incur credit of \$1,000.00 or more without disclosing to a prospective lender that you are bankrupt;
- Conceal assets;
- Stop, attempt to stop, or hamper the Official Assignee dealing with any property or assets;

- In the event that you have a windfall, ie win lotto, receive an inheritance under a Will, you must disclose this to the Official Assignee. Failure to do so will be considered a breach of your obligations under the bankruptcy. The Official Assignee may take all or any of a windfall;
- Upon entry to bankruptcy, the Inland Revenue Department will cancel your existing IRD Number and issue you with a new one. The Inland Revenue Department will forward any refunds direct to the Official Assignee during the course of your bankruptcy for the benefit of your creditors.

Taranaki Bankruptcies

The Official Assignee at Hamilton deals with Taranaki bankruptcies.

NO ASSET PROCEDURE

This is a new procedure which came into being with the introduction of the Insolvency Act 2006.

Criteria

A debtor may be admitted to the no asset procedure if the Assignee is satisfied on reasonable grounds that:

- The debtor has no realisable assets;
- The debtor has not previously been admitted to the no asset procedure;
- The debtor has not previously been adjudicated bankrupt;
- The debtor has total debts (excluding student loans) that are not less than \$1,000.00 and not more than \$40,000.00; and
- Pursuant to a prescribed means test, the debtor does not have the means of repaying any amount towards these debts.

The debtor is able to retain the same assets as a bankrupt as set out under “Assets” on page 5.

A debtor will be disqualified from entry into the no asset procedure in certain cases:

- Where the debtor has concealed assets with the intention of defrauding creditors by, for example transferring property to a trust;
- The debtor has engaged in conduct that if he/she were a bankrupt would constitute an offence under the Insolvency Act 2006;
- The debtor has incurred debts knowing that he/she does not have the means to repay them; or
- A creditor intends applying for the debtor’s adjudication as a bankrupt and it is likely that the outcome for the creditor if the debtor is adjudicated bankrupt will be materially better than if the debtor is admitted to the no asset procedure.

Effect of entry into the no asset procedure

As with a bankruptcy a creditor must not after the debtor has been admitted to the no asset procedure continue to try to collect a debt that is owed at the time of the no asset procedure.

As with bankruptcy there are certain debts which survive the no asset procedure and these are:

- Maintenance orders under the Family Proceedings Act 1980;
- Child support under the Child Support Act 1991;
- Student loans; and
- Court fines and reparations.

Offences

The debtor may not obtain credit (including hire purchase credit) either alone or jointly with another person in excess of \$100.00 without first advising the creditor that he/she is subject to the no asset procedure.

A debtor who commits an offence is liable on summary conviction to imprisonment for a term not exceeding one year or a fine not exceeding \$5,000.00 or both.

Termination

A debtor is automatically discharged from the no asset procedure 12 months after the date on which the debtor was admitted to the procedure.

Once the debtor is discharged, the debts that became unenforceable on the debtor's entry to the no asset procedure are cancelled and the debtor is not liable to repay any part of the debts, including any penalties or interest.

NEW ZEALAND INSOLVENCY AND TRUSTEE SERVICE OFFICES

Phone

0508 INSOLVENCY (0508 467-658)

Northern Region

Level 18, ASB Centre, 135 Albert Street, Auckland 1010

National Enforcement Unit

ASB Centre, 135 Albert Street, Auckland 1010

Midland Region

Level 2, 678 Victoria Street, Hamilton 3204

Central Region

205 Victoria Street, Wellington 6011

Napier and Proceeds of Crime Unit

Level 2, PricewaterhouseCoopers Building, 36 Munroe Street, Napier 4110

Southern Region

Southern Business Centre, 55 Wordsworth Street, Sydenham, Christchurch 8023

HOW WE CAN HELP YOU

Govett Quilliam is Taranaki's largest law firm. We have the people, the experience and the resources to assist you, whatever your case may be.

We have prepared this guide as a guideline to insolvency and bankruptcy. If you require further information, or have any questions about this guide please contact us.

Our Partners with experience in insolvency and bankruptcy are:



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