BELL GULLY

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Submission on Report No.1 of the Insolvency Working Group

1. We first would like to congratulate the Ministry and the Insolvency Working Group on their first report, Review of Corporate Insolvency Law ("the Review"). It is an excellent report, particularly in regards to the long-needed regulation of insolvency practitioners, and we endorse the majority of its recommendations.

Measure 1 Goes too Far

2. We have concerns in relation to a proposal in the second half of the Review, Measure 1. This proposal would remove the ability of shareholders' and directors' to appoint a liquidator or voluntary administrator after service of a liquidation application.

3. At present, as per section 241AA(2) of the Companies Act 1993 ("the Act"), shareholders or directors can voluntarily appoint a liquidator up to 10 working days after service on the company of a liquidation application by a creditor, without the petitioning creditor's consent. A voluntary administrator may be appointed during the same period under section 239I(4) of the Act.

4. The Working Group expressed the concern that this 10 day period provides the company with the opportunity to appoint a debtor-friendly, incompetent or dishonest liquidator. They propose to remove the 10 day period and disallow the company from appointing a liquidator entirely. To close a potential loophole, the proposal would also prohibit the appointment of voluntary administrators after an application to appoint a liquidator is filed.

5. Although we understand the concern motivating this proposal, we are concerned that it fails to appropriately strike the balance between, on the one hand, minimising the risks that arise in a debtor-initiated insolvency process (in particular the appointment of a debtor-friendly liquidator) and, on the other hand, allowing responsible directors and insolvency practitioners the freedom to undertake legitimate restructuring and legitimate insolvency appointments.

6. To a significant extent, the mischief that the proposal is directed towards will be addressed by the formal regulation of practitioners also proposed by the Working Group. The risk of a practitioner accepting appointment as liquidator or voluntary administrator and then conducting themselves in a way which would justify the prohibition proposed by the Working Group is reduced by these proposals.

7. In that context, we consider that the proposed Measure 1 is too restrictive. In particular, we consider this proposal:

   (a) Inappropriately limits legitimate restructuring opportunities that would otherwise be available to directors' faced with liquidation applications. Directors faced with an application to liquidate may legitimately consider that the business can be saved if steps are taken quickly by an administrator.[1] An administrator's appointment shifts power from the directors to the administrator, who is subject to the supervision of the creditors as a whole and will be regulated. The proposed changes will make that option significantly slower and more difficult to implement, especially in the face of opposition from a hostile creditor. It is questionable whether the mischief being addressed justifies those costs and delays. .[2]

   (b) May lead to the company becoming financially worse off. If the petitioning creditor refuses to approve the appointment of a certain liquidator or voluntary administrator, then there will be delays in making an application to the Court. Liquidation applications can be contested and take six months or more to resolve. In the interim, company assets may dissipate through the company continuing to trade (within the ordinary course of business). Directors may cause the company to continue to incur liabilities. This loss will eventually be borne by creditors upon the winding up of the company.

   (c) Assumes that the petitioning creditor will act in the interests of all of that company's creditors. In practice, the petitioning creditor may often appoint a liquidator partial to them. There is a risk that a petitioning creditor may use this procedural advantage to seek to use payment of their debts in a more favourable way than other creditors.

   (d) Places the petitioning creditor in a position of disproportionate strength in relation to any proposed appointment. This proposal may create an unintended incentive on creditors to be the first to make an application, in circumstances where continued engagement – and possibly a voluntary administration – would be better for creditors overall.

Conclusion

8. Overall, the proposal in measure one when put into practice may not operate to the benefit of the creditors as a whole. The proposal attempts to reduce the risk of appointment of a debtor-friendly liquidator. The 10 day period currently in place already reduces this risk by giving time for the petitioning creditor to review the appointment of that liquidator.

9. We believe formal regulation of insolvency practitioners will address the issues arising in debtor-initiated insolvency processes.[3] Measure 1 goes too far in limiting the freedom of

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[1] A director's ability to take steps to restructure by selling the company's assets after a liquidation application has been served will be constrained if Measure 2 is accepted. This makes Measure1 of greater importance.

[2] The Australian equivalent of the Act disallows the appointment of a liquidator after service of a liquidation application, but does not extend as far as disallowing the appointment of a voluntary administrator: See Corporations Act 2001 (Australia) sections 436A and 490. As in Australia, we consider the fact that a Voluntary Administration may result in a liquidation is not a sufficient justification for the provision to extend to this situation.

[3] For the same reason, we consider that consideration should be given to removing the existing 10-day rule in relation to voluntary administrators in s 239I(4) of the Act.

companies in order to mitigate risks and facilitate remedies already addressed by the Working Group through insolvency practitioner regulation.

Yours faithfully
Bell Gully

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