KensingtonSwan
*LAWYERS

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Email: Corporate.Law@mbie.govt.nz

Ministry of Business Innovation and Employment
PO Box 1473
Wellington 6140

Review of Corporate Insolvency Law

Submission to the Ministry of Business, Innovation and Employment by Kensington Swan on Report No. 1 of the Insolvency Working Group relating to insolvency practitioner regulation and voluntary liquidations

Introduction

Thank you for the opportunity to submit on the recommendations made in Report No.1 by the Insolvency Working Group dated 27 July 2016 ('the Report'). Our submission comments on the Report generally, before addressing the questions for submitters on the Report.

Kensington Swan is a premier New Zealand law firm with over 30 partners and more than 150 staff based at offices in Auckland and Wellington. The firm has an active insolvency and restructuring team that takes a keen interest in developments relating to insolvency law and practice.

General Comments

The Report is a helpful review of the issues relating to the regulation of insolvency practitioners and the harms that can arise from voluntary liquidation. We thank members of the Insolvency Working Group for the time, effort and expertise they have invested in the Report.

We support most of the recommendations made in the Report as they relate to the Insolvency Practitioners Bill,[1] co-regulation,[2] changes to improve the High Court supervision of liquidators[3] and the additional changes proposed to address the harms of some voluntary liquidations.[4] Where our views differ to those expressed in the Report, we have indicated as such. In particular, we consider that only regulated insolvency practitioners should be involved in administrating or managing creditors' compromises. Further, we are at this stage unconvinced that the benefits of a unique identification number for directors will outweigh the costs of this measure.

Most importantly, we agree with the Report that the licensing of insolvency practitioners is vital to improving confidence in the industry and raising professional standards. New Zealand is an outlier in not having formal occupational regulation for insolvency practitioners.[5] A licensing system will disadvantage some existing practitioners, but that is inevitable, given the existing low barriers to entry to performance of insolvency assignments. We agree that licensing will cure much of the harm associated with voluntary liquidations.

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[1] Recommendations R1 and R2 of the Report.
[2] Recommendations R3 to R8 of the Report.
[3] Recommendations R9 and R10 of the Report.
[4] Recommendations R11 and R12 of the Report.
[5] See paragraph [34] of the Report.

We also agree that the provisions of the current Insolvency Practitioners Bill not relating to regulation be enacted with the amendments proposed by the Working Group. In respect of the proposed changes to s280 in particular, the amendments are overdue.

We look forward to publication of the Working Group's second report, which we understand will address the current voidable transactions regime, an area where we consider there is much scope for reform.

Questions for Submitters on the Report

Insolvency practitioner regulation

Question 1: *Do you agree with the Working Group's views on the problems with the status quo? What is the scale of harm being caused by these problems*?

Yes. We agree that it is too easy for dishonest and incompetent individuals to become insolvency practitioners. We also agree that maintaining the status quo is not a viable option.[6]

There are insufficient barriers to entry for individuals wishing to hold themselves out as insolvency practitioners. It is troubling that insolvency practitioners are, for example, entrusted with funds on behalf of creditors and shareholders when they are not obliged to meet the standards of any professional organisation. As the Report points out, there are no meaningful competence-related criteria for insolvency practitioners.[7]

Our experience is that incompetence, rather than dishonesty, is the main issue with the status quo (although incidents of dishonesty attract more publicity). There is a minority of practitioners, particularly when they are involved in or contemplating recovery actions, who do not pay sufficient attention to the duty to administer insolvencies in a reasonable and efficient manner.

It is too difficult to address issues with liquidators without clients incurring considerable expense, particularly through the court process.

Question 2: *Do you agree with the listed objectives of insolvency practitioner regulation*?

Yes.

Question 3: *Do you generally agree that changes proposed in the Insolvency Practitioners Bill that do not relate to the registration regime proposed in that Bill along with the additional related changes proposed by the Working Group should be progressed?*

Yes. As the changes proposed are numerous and some quite technical, we focus on only a select few for comment. We agree that the proposed changes to s280 of the Companies Act are urgently needed.[8] Section 280, as it currently stands, prohibits the appointment of liquidators or administrators who have:

- provided professional services to a company (for example, as investigating accountants) (s280(1)(ca)); or

[6] See paragraph [83] of the Report.
[7] See paragraph [56] of the Report.
[8] See Item 1 of Table 1 to the Report.

- a continuing business relationship with any of the company's secured creditors (s280(1)(cb)).

As the Report acknowledges, this prohibition is too broad. It excludes insolvency practitioners from appointment who are suitable because they are already familiar with the company or who are recognised as being reputable and competent practitioners by the banks.[9] Often, no meaningful conflict exists. As such, the prohibition is inefficient and costly, and we support its removal.

We agree with the Working Group that it is sensible to align the period that liquidators and receivers are required to hold accounts and records of a liquidation / receivership. Currently, liquidators are only required to hold documents for a year, while receivers are required to hold them for six years.[10] The Working Group proposes six years for both liquidators and receivers, which ties in with the Limitation Act.

We also particularly support the requirement of liquidators to deposit funds of a company under their administration at a bank, and in either a bank account to the credit of the company or a trust account.[11]

In addition to the proposed reforms, it might be useful to consider whether s255 of the Companies Act should be amended to clarify the means by which liquidators can send their reports to creditors and shareholders (e.g. by email or by posting the reports on a website). Posting reports by mail to several thousand creditors can be an unduly expensive exercise.[12]

Question 4: *Do you agree with the proposed changes to the High Court supervision of liquidators*?

Yes. We agree that the High Court should retain its general supervisory role in respect of liquidators, and with the proposed changes to ss 284, 285 and 286 of the Companies Act.

Question 5: *What are your views on the four occupational regulation options proposed by the Working Group*?

We consider that Option C (co-regulation) is the best option for insolvency practitioners.

We agree that licensing of insolvency practitioners is required to promote confidence in the industry. Option A, registration as proposed by the Insolvency Practitioners Bill, is inadequate and misleading, because it does not link registration to any requirements for qualifications, experience and good character.[13] As the Report points out, the public may expect that because a person's name appears on the register, they would have been vetted to see if they meet certain minimum standards of competence, when that is not the case.[14] Option A is therefore unsuitable.

Option B, no statutory occupational regulation, is also unsatisfactory, as it would leave the status quo in place, with the present CAANZ / RITANZ accreditation scheme. That scheme certainly has its merits, but it is voluntary and therefore has, as the Report says, "*...an unavoidable lack of comprehensiveness*."[15]

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[9] See paragraphs [86] to [96] of the Report.
[10] See Item 10 of Table 2 to the Report, as well as s256(1)(b) of the Companies Act 1993 and s22(2) of the Receiverships Act 1993.
[11] See Item 11 of Table 2 to the Report.
[12] See, for example, *Re Dominion Finance Holdings Ltd (in liq)*, 1 October 2009, Associate Judge Robinson, HC Auckland CIV-2009-404-6606, where the cost of sending a half annual report to every creditor was $5,621.
[13] See paragraph [127] of the Report.
[14] Ibid.
[15] Paragraph [131] of the Report.

In our view, Option C is the best option because it promotes competence standards and would build on the architecture of regulation already put in place by CAANZ and RITANZ. That latter body is the natural candidate to be the accredited professional body issuing licences to insolvency practitioners and carrying on what the Report calls "*frontline*" regulation of practitioners.[16]

Option D, Government licensing with a single regulator, is less attractive. A government regulator would not be so 'close to the action' and this option would exclude practitioners from their own regulation, when, in our view, there is much to commend the continuing involvement of the profession in its own regulation (much like the position with lawyers and the Law Society). Option D is also likely to be less cost-effective than Option C.

Question 6: *Do you agree with the details of the co-regulation system recommended by the Working Group*?

In the main, yes. However:

- We consider that only regulated insolvency practitioners should be involved in administrating or managing creditors' compromises. This is because these individuals are often overseeing the realisation of assets, administrating claims and holding funds. While we accept that there is no statutory office of 'compromise manager', independent parties often assist proponents with compromises, and these are usually insolvency practitioners. The voting arrangements for compromises, in particular, often involve some complexity.
- The question of whether solvent liquidations should be reserved to licenced insolvency practitioners is likely to attract a diversity of views. We agree with the approach adopted by the Working Group, but acknowledge that there is also merit in the argument that all liquidations should be carried out by registered insolvency practitioners.

We consider that the Working Group's recommendation requiring overseas practitioners to be licensed, or be licenced under an overseas system recognised in New Zealand, will be met with general approval.[17] There has been disquiet about Australian practitioners operating in New Zealand when New Zealand practitioners cannot do the same across the Tasman.

Question 7: *Are there other feasible options to address the problems identified by the Working Group with the provision of insolvency services*?

No.

Question 8: *An alternative option for regulating insolvency practice would be to only require the practitioner to be a member of a professional body, such as CAANZ or RITANZ, without any oversight from an independent government regulator. Would this option provide a more cost-effective model for regulating insolvency practitioners*?

Yes, this option would be more cost-effective, but it would come without the benefits of Option C, co-regulation. Those benefits are outlined in paragraphs [132] and [133] of the Report.

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[16] Paragraph [121] of the Report.
[17] Recommendation R6 of the Report.

Question 9: *Should insolvency services be restricted to only certain members of an accredited professional body, as opposed to all members of the accredited professional body? If so, what criteria should be applied to determine which members of the accredited professional body would be permitted to provide insolvency services*?

Only members of an accredited professional body that have the necessary qualifications, experience and good character should be able to perform insolvency services. Not all members of CAANZ or RITANZ should be permitted to carry out insolvency assignments.

We agree, however, that solvent liquidations should not be reserved to licensed insolvency practitioners, provided that:

- solvent liquidations can only be carried out by individuals subject to professional standards, such as accountants and lawyers; and
- a liquidation is immediately transferred to a licensed insolvency practitioner if the individual acting as liquidator becomes aware that the liquidation is not solvent.[18]

The Report has identified the desirability of a fit and proper person test, as well as a test to ensure that a practitioner has the necessary skillset.[19] Criteria of this nature should be applied to CAANZ and/or RITANZ members.

Question 10: *How might the different options impact on competition within the insolvency services sector? How would the different options impact on the availability of insolvency services to businesses and creditors outside the main centres of New Zealand?*

Co-regulation is likely to mean that there are fewer individuals offering insolvency services. Some existing practitioners will be excluded from carrying out insolvency assignments. This is because not all current practitioners will meet the proposed character and competence criteria. We do not see this as a negative consequence of the proposed regime. The industry would be improved by the removal of incompetent or dishonest practitioners.

Given the small size of the country, and the concentration of commercial activity in the main centres, we would not expect co-regulation to adversely impact on the availability of insolvency services outside the main centres. Most experienced and capable insolvency practitioners are willing, in any respect, to travel outside of the main centres to provide their services.

Voluntary liquidations

Question 11: *Do you agree that introducing a licensing regime for insolvency practitioners would reduce much of the harm raised by aspects of the voluntary liquidation process*?

Yes.

Question 12: *Do you agree that the latent defect problems in the building and construction sector are issues best solved by building and construction sector law and should not be directly addressed by changing insolvency law? If not, what would you suggest*?

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[18] See paragraphs [149] and [150] of the Report.
[19] Paragraph [122] of the Report

Yes. We are pleased that the Working Group has not recommended any changes that would 'pierce the corporate veil' and expose shareholders to further liability.[20] Doing so would undermine the value of the limited liability company as the primary vehicle for undertaking business risks.

We are particularly concerned about the behaviours that would arise if liquidations were delayed for several years because of the potential for latent defects.[21]

Question 13: *Do you agree that one, some or all of the three measures proposed by the Working Group will address the harm of some voluntary liquidations*?

The three measures are:[22]

1. Removing the ability to appoint a liquidator after service of a liquidation application.
2. Avoiding the transfer of assets after service of a liquidation application.
3. Introducing a director identification number.

We agree that the first two measures, at least, will address the harm of some voluntary liquidations. Dispensing with the 10 day rule[23] will simplify and improve the law by removing arguments about when a liquidation application was served, and the appointment of "debtor-friendly" liquidators. We expect, however, that this proposed change may not be universally welcomed by all insolvency practitioners, as it may be perceived to favour the existing firms that provide liquidation services to the Inland Revenue Department, which we understand is the largest petitioning creditor for liquidations.

We do not agree that the proposed change should necessarily also apply to voluntary administrations. Given the corporate rehabilitation objectives of Part 15A of the Companies Act,[24] shareholders should be encouraged to appoint administrators. Creditors have an early opportunity at the mandatory first creditors' meeting to replace administrators.[25]

We agree that shareholders should be allowed to appoint a liquidator after the service of a liquidation application with the approval of the petitioning creditor or the court.[26]

We also agree that there should be a restriction on the transfer of a company's assets once a liquidation application has been served.[27] Such a restriction would be a significant change in the law, but a provision that renders void any transfer of assets, outside the ordinary course of business, after the service of an application has merit. We observe that the phrase "ordinary course of business" has, however, in the past, created uncertainty in practice.[28]

We are less convinced by the third measure, the introduction of a director identification number. We expand on that point below in our answer to Question 14.

Question 14: *Do you agree with the benefits of a unique identification number for directors*?

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[20] See paragraphs [179] to [186] of the Report.
[21] Paragraph [186] of the Report.
[22] Paragraphs [187] to [200] of the Report.
[23] Section 241AA of the Companies Act 1993.
[24] Section 239A of the Companies Act 1993.
[25] Sections 239R and 239AN of the Companies Act 1993.
[26] See paragraph [190] of the Report.
[27] See paragraphs [192] to [198] of the Report.
[28] *Insolvency Law & Practice* (online looseleaf ed, Thomson Reuters) at [CA292.02].

We are less certain that this measure will reduce the harms of some voluntary liquidations. Even if it did, we are concerned about the considerable ongoing compliance cost for the Companies Office and the large number of directors in New Zealand (who number over half a million, based on the 550,000 companies currently in existence). The Companies Office would need to comply with the requirements of Privacy Principle Twelve in assigning unique identifiers.[29] That Principle would require the Companies Office to take all reasonable steps to ensure that unique identifiers are assigned only to those individuals whose identity is clearly established.

In any event, directors of failed companies have been known to use their relatives as directors of their new enterprises, so a unique number would not be a failsafe means of identifying and following individuals who have been involved with previous corporate failure.

More information is required about the cost and administrative burden involved with implementing a unique identification number for directors before it can be said that its benefit would outweigh its cost.

Question 15: *Do you have any other comments on Report No. 1?*

Please see our general comments at the beginning of this submission.

Conclusion

We would be happy to discuss any aspect of our submission with you.

Yours faithfully
Kensington Swan

James McMillan
Partner

P: +64 9 375 1154
E: james.mcmillan@kensingtonswan.com

Nicole Xanthopol
Partner

P: +64 9 914 7252
E: nicole.xanthopol@kensingtonswan.com

[29] Section 6 of the Privacy Act 1993.