Simpson Grierson

Questions for submitters on Report No. 1 *(Please note: references to paragraphs are to paragraphs in the Report)*	
Insolvency Practitioner regulation	
1.	We agree with the Working Group's views on the problems with the status quo, and that it has accurately identified the main causes (paragraph 55). The scale of the harm caused by these problems is, by its nature, difficult to quantify. The incidence of dishonest or egregious behaviour by insolvency practitioners is infrequent, although the case studies referred to by the Working Group evidence that the problems are real. A further recent example is *McKay v Johnson* [2016] NZHC 466, in which the liquidator, Mr Smith, was found liable for failing to account to a secured creditor and ordered to pay over $500,000. The Court also held that Mr Smith fabricated evidence in the course of the proceeding. Mr Smith also failed to comply with his statutory reporting obligations as liquidator and had three previous convictions for dishonesty offences. In our experience, the problems associated with self-interest (for example, unnecessary incurring of fees by liquidators (paragraph 40)), debtor-friendly behaviour (for example, failing to investigate or pursue related party transactions or breaches of directors' duties (paragraphs 41 to 43)), and substandard decision-making (paragraphs 44 and 45) are more prevalent. In isolation, the level of the harm caused by each incident of this nature may not be significant. However, when aggregated, the harm is substantial. Perhaps more importantly, the infrequent but significant levels of harm caused by the more egregious breaches, and the more common but less significant level of harm caused by the more minor breaches, both have a detrimental impact on the commercial public's confidence in New Zealand's insolvency regime. In the context of such a technical, and often complex, area as corporate insolvency, where insolvency practitioners are effectively custodians of other people's entitlements and make decisions affecting their interests, the absence of competence-based regulation (underpinned by enforceable professional and ethical standards, and a disciplinary procedure) is anomalous and is out of step with other comparable jurisdictions.
2.	We agree with the objectives listed in paragraphs 78 to 81.
3.	We generally support the changes proposed in the Insolvency Practitioners Bill that do not relate to the proposed registration regime, with the additional related changes proposed by the Working Group. By way of further comment: • Annex 3, Table 1, Item 1 – we agree with the Working Group's views as to the proposed, and additional, changes to the appointment disqualification regime, and in particular we support the proposed s 280(3)(a), clarifying the position of investigators/monitors/advisors; • Annex 3 – we agree with the Working Group's view that the proposals to list payer and payee details in various reports is unnecessary and potentially onerous; • Annex 3, Table 2, Item 23 (New) – we are not persuaded that it should be mandatory for a receiver to include in their notices of appointment the name of the appointing creditor - the basic purpose of the notices is to

	advise of the fact, and extent, of the receivership and of the receiver's contact details, and the identity of the appointor is irrelevant in that context (and the appointor's identity is readily ascertainable in other ways); and • Annex 3, Table 3, Item 24 (New) - we agree with the Working Group's view that it would be useful for the Registrar to prescribe the form of a summary report to be filed by administrators, receivers, and liquidators at the conclusion of their administrations, provided that completing the report will not be onerous as the additional compliance cost will be borne by creditors.
4.	We support the proposed changes to the High Court supervision of liquidators.
5.	Of the four occupational regulation options proposed by the Working Group, for the reasons advanced by the Working Group we support the co-regulation option.
6.	We generally support the details of the co-regulation system recommended by the Working Group, more specifically: • we endorse the comments in paragraph R5 as regards solvent liquidations; and • we consider that New Zealand residency ought to be a requirement of licensed insolvency practitioner status. Mandatory New Zealand residency provides for greater accountability, and reduces commercial inconsistencies (for example, higher hourly charge out rates of foreign insolvency practitioners). This would also be consistent with the approach adopted in Australia, for example. It would not affect a foreign insolvency practitioner being recognised under a cross-border insolvency proceeding; The question of whether compromises should be included is more difficult, and we note that the recent decision in *Advicewise v Trends Publishing* [2016] NZHC 2119 illustrates some of the issues. We have mixed views in respect of the Working Group's recommendation (paragraph 148) that compromises should not be included. On the one hand: • the absence of a prescribed role for an insolvency practitioner under Part 14 makes identification of the persons to whom regulation is to apply potentially difficult (and risks capturing mere advisors); • even where a "compromise manager" of some description is appointed under a compromise proposal, their role is conceptually different from that of a liquidator, receiver or administrator, and they have no direct statutory powers; • Part 14 compromises typically result in the company's board remaining in control (albeit subject to the terms of the compromise proposal); and • the primary complaints in the *Advicewise* case related to the structuring of the compromise proposal as voted on by the creditors (and the structuring of that vote), rather than to its subsequent administration by the "compromise managers". On the other hand: • (as is evidenced by the *Advicewise* case) insolvency practitioners can play a fundamental role in the formulation, structuring and implementation of a

	compromise proposal; • structuring compromise proposals, and having them properly placed before creditors, can require considerable technical knowledge and skill; • as compromise proposals can have a serious impact on creditors' rights, their structuring, promotion and implementation require no less a level of integrity than for other insolvency processes; and • challenging an approved compromise proposal necessarily involves litigation, which is not only expensive but also involves uncertain timeframes which can leave the subject company in a difficult period of limbo.
7.	We are satisfied that the Working Group has identified the most feasible options to address the problems identified by them as to the provision of corporate insolvency services.
8.	We support the Working Group's conclusion that a co-regulation model provides a better overall solution than a purely industry accreditation model.
9.	The concept of the provision of corporate insolvency services being restricted to only certain members of an accredited professional body, as opposed to all members of the accredited professional body, would not fit comfortably with the co-regulation regime proposed by the Working Group. If the co-regulation regime is properly established, and a practitioner qualifies under it, then accreditation to additional professional bodies should not be mandatory.
10.	In our experience, in the main centres and the larger provincial centres, there is no shortage of competent competition in the provision of corporate insolvency services. Further, in our experience, that competitive situation extends to the servicing of more remote centres. Given the specialised and technical nature of corporate insolvency services, we would not support a situation where the co-regulation regime, or the standards required by it, were in any way compromised on the grounds of geographic or population considerations.
Voluntary liquidations	
11.	We would expect that introducing a licensing regime for corporate insolvency practitioners would reduce the harm raised by aspects of the voluntary liquidation process as identified by the Working Group. The incidents of abuse or extreme incompetence which typically gain publicity, or come before the courts, are only one level of harm which could be expected to be reduced. We would anticipate that a co-regulation regime as proposed by the Working Group could also have a more widespread benefit - by reducing the incidence of less egregious, and less obvious, harm caused by simple ignorance or incompetence.
12.	We strongly 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 corporate insolvency law.

	The question of liability for latent defects raises much wider issues than those relating to the general law of corporate insolvency, including as to: the parameters of corporate personality; the appropriate scope of limited liability; the relevance of limitation periods; the role of contributory negligence principles; questions around defect discoverability; appropriate allocation of risk, including between those with joint liability; the proper scope of directors' duties and liability for breach; the proper extent of shareholder liability; the relevance of industry practices; the role of insurance; and issues around standing and remoteness of claims.
13.	In respect of the three measures proposed by the Working Group in paragraphs 187 to 200: 1. **Measure 1 – Appointment of a liquidator after service of a liquidation application** We are not persuaded that the Working Group's recommendation is desirable, and therefore do not support it, because: • the implementation of the proposed co-regulation regime could be expected to reduce the risks of "*a debtor-friendly, incompetent or dishonest liquidator*" being appointed; • the current 10 working day period provides directors with a reasonable time to assess the appropriateness of liquidation or voluntary administration; • the inability to seek appointment of a liquidator once filing/service of an application occurs puts directors into a difficult position where they consider liquidation to be appropriate, their only options being to: o seek the applying creditor's consent – the outcome of which depends on the motivation, and reasonableness, of individual creditors (and there is no general duty on creditors to act other than in their own interests); o apply to court – which is not a cheap option, and involves an uncertain timeframe; or o resign – which will often be to the detriment of all stakeholders (a corporate vacuum may result, as replacement directors are likely to be very difficult to locate), but may be unavoidable from a directors' duty perspective if the directors are prevented from initiating liquidation; • similarly, directors ought to be able to appoint an administrator within the current 10 working day period if they properly determine that voluntary administration is or may be preferable to liquidation (to which end the voluntary administration regime was added to New Zealand corporate law in 2007). Creditors may be adversely affected, and the voluntary administration regime undermined, if this option is removed; • furthermore, an entity which is insolvent ought to be placed into a formal insolvency procedure (liquidation or voluntary administration) as soon as possible in order to protect creditors' interests. A creditor's liquidation application typically takes over a month (and sometimes much longer) to be determined by the High Court. Preventing an insolvent entity being placed into a formal insolvency procedure because of a disagreement between the creditor and the entity over the identity of the proposed liquidator, or the form of the formal insolvency procedure, is unlikely to be in the best interests of creditors as a whole; and

- creditors retain the ability under s 243 to resolve to appoint a replacement liquidator (and a replacement administrator under s 239R), or to require a meeting for that purpose under s 245, and the applying creditor has the right to seek review under s 241AA.

2. **Measure 2 – Avoidance of Asset Transfers**

We do not support this recommendation of the Working Group in its current form, because:

- such a provision would be expected to have a significant, and disproportionate, adverse effect on normal commercial business transactions, by introducing uncertainty into any purchase of assets from a company, other than where patently "*in the ordinary course of business*";
- the response, by well-advised purchasers, could be expected to include expensive and inefficient "due diligence" procedures;
- there is no inexpensive and reliable, real-time mechanism for a purchaser to check whether or not a liquidation application has been filed/served in any of the court registries – which could be expected to lead to complicated, expensive and inefficient settlement requirements (potentially involving escrow, or similar, arrangements);
- the phrase "*ordinary course of business*" has a notorious history, and would not provide a certain "safe harbour" in any but the most basic trading transactions involving ordinary inventory sales;
- transactions "*in the ordinary course of business*" are only a subset of the kinds of innocent transactions by which companies dispose of assets;
- placing the onus, and burden, on innocent purchasers to validate otherwise unremarkable transactions which happened to occur after a liquidation application had been filed/served, could be expected to create hardship and injustice:
  - going to court to seek validation is expensive, and involves an uncertain timeframe; and
  - liquidators' responses to requests for ratification cannot safely be anticipated, and may also involve expense (in this regard we have direct, and unfortunate, experience of a range of responses, including as to requirements for cost "reimbursement", to requests made to liquidators under s 31(2)(b) of the Receiverships Act for the granting of agency).

In short, the wider, non-insolvency-focussed, business and commercial community could be expected to be very interested in (and more than a little concerned by) the implications of this recommendation. The problems caused would likely dwarf the problem solved.

We note that the Working Group's concern is expressed in terms of the "*rapid transfer of assets, often at undervalue or no value, by shareholders and directors*". Such transfers have little commercial logic unless they are in favour of entities related to the offending directors/shareholders. The Working Group's reference to "*phoenix arrangements*" also suggests that its focus is primarily on related party transactions. The existing statutory remedies available to liquidators are sufficient to address this mischief.

3. **Measure 3 – Director Identification Numbers**

Please see our response to Question 14 below.

14.	We are not persuaded that a regime involving a unique identification number for directors – with its associated costs, bureaucracy and inconvenience – is justified, and we therefore do not support it. Given the comparatively small number of directors who cause serious problems, and the subset of those where identity is a major issue and tracking by such a number is going to provide the only solution, this proposal risks inconveniencing (and, potentially, alienating) a disproportionately large number of innocent current and potential company directors, and necessitating unspecified expenditure (including as to establishment, monitoring and compliance) for a questionable degree of benefit. It is also questionable whether an identification number will achieve the desired outcome as unsophisticated users of the collated data may wrongly assume that directors of former companies which have been removed from the Register are directors of "failed companies" (a term which is not defined by the Working Group). In any case, if such a regime were to be proposed then we suggest that much wider consultation would be appropriate, to reflect that insolvency considerations are just one aspect of a wide range of considerations relevant to a proposal which would affect all present and future company directors in New Zealand.
15.	We have no other comments on Report No. 1, and wish to express our gratitude to the Working Group for its work.