Russell McVeagh

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Insolvency Working Group
Ministry of Business, Innovation & Employment

By post and email

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INSOLVENCY WORKING GROUP REPORT NO. 2 - RUSSELL MCVEAGH SUBMISSIONS

1. Russell McVeagh thanks the Insolvency Working Group for the opportunity to make a submission on the "Review of Corporate Insolvency Law - Report No.2 of the Insolvency Working Group, on voidable transactions, Ponzi schemes and other corporate insolvency matters".

2. We set out in the enclosed Schedule our comments responding to certain of Insolvency Working Group's questions.

3. This submission represents the views of Russell McVeagh. Whilst it is based on the firm's experience in advising clients on all aspects of insolvency law, it is made on behalf of the firm and not its clients.

4. All enquiries on this submission may be directed to the authors of the submission (noted below).

5. We would also be happy to meet with the Insolvency Working Group to discuss our submission further if that would assist.

Yours faithfully
RUSSELL McVEAGH

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SCHEDULE

VOIDABLE TRANSACTIONS, PONZI SCHEMES AND OTHER CORPORATE INSOLVENCY MATTERS		
VOIDABLE TRANSACTIONS		
1.	(a)	**Do you agree with the Insolvency Working Group's assessment of the impact of the Supreme Court's decision in *Allied Concrete v Meltzer* on New Zealand's voidable transactions regime? (paragraphs 32-34).**
	(b)	**If not, what is your assessment of the impact of the decision?**
	1.	We generally agree with the Insolvency Working Group's ("**IWG**") assessment of the Supreme Court's decision in *Allied Concrete v Meltzer* on New Zealand's voidable transactions regime.
	2.	The effect of *Allied Concrete* has been that more individual creditors have been able to rely on the "gave value" defence than under the previous position (with the effect that the "altered position" defence has been rendered (largely) irrelevant).
	3.	The fact that more individual creditors are able to rely on s 296(3) of the Companies Act 1993 ("**Act**") to prevent "clawback" has meant that there will often be less money in the general pool for liquidators to distribute to unsecured creditors.
2.	(a)	**Do you agree with the Insolvency Working Group's listed objectives of the voidable transactions regime? (paragraph 53)**
	(b)	**Should other objectives also be considered?**
	(c)	**What weighting should be given to the objectives, e.g. equally or differently?**
	1.	We broadly agree with the IWG's listed objectives of the voidable transactions regime, as outlined at paragraph 53 of the Report.
	2.	In *Allied Concrete*, the Supreme Court noted (at paragraph [77] of the judgment of Arnold J) that the legislative history of s 296 indicates that Parliament intended to align New Zealand's good faith defence with that of Australia. In considering the package of changes recommended by the Report, the IWG should also consider the desirability of maintaining consistency with the equivalent Australian provisions.
	3.	We not take a view as to which, if any, of the three objectives listed at paragraph 53 should be given greater priority over the others.

VOIDABLE TRANSACTIONS, PONZI SCHEMES AND OTHER CORPORATE INSOLVENCY MATTERS VOIDABLE TRANSACTIONS		
3.	**(a)** **(b)**	**Do you agree with the Insolvency Working Group's views on the problems with the status quo? (paragraphs 56-69)** **Are there other problems?**
	1.	We generally agree with the IWG's views on the problems with the status quo.
	2.	However, we note that the status quo is that *Allied Concrete* clarified the interpretation of the "gave value" defence under s 296(3), which operated to give greater business certainty in respect of the current two-year clawback period. To repeal the "gave value" test is likely to result in greater business uncertainty for creditors (for whatever clawback period will operate).
4	**(a)**	**What are your views on the package of changes recommended by the IWG in Ch 1?**
	1.	We do not take a position on the package of changes recommended by the IWG in Chapter 1 of the Report.
	2.	However, as noted below, we agree that R1 and R2 should only be implemented as a package, in order to achieve an appropriate weighting of the objectives set out at paragraph 53 of the Report.
	3.	We also consider that the IWG should further consider the desirability of maintaining consistency with Australian law. For instance, repealing the "gave value" part of the test will mean that New Zealand is no longer aligned with s 588FG(2)(c) of the Corporations Act 2001.
4.	**(b)**	**Do you agree with the IWG that R1 and R2 need to be implemented as a package?**
	1.	If the IWG's recommendations regarding the voidable transactions regime are carried forward, Russell McVeagh agrees that R1 and R2 should be implemented as a package.
	2.	We also submit that R7 ought to form part of the "package", in order to enhance business certainty for individual creditors by reducing the deadline for liquidators to file claims in the High Court under ss 292 and 299 from six to three years.
	3.	We consider that if the "gave value" defence is to be repealed, then it should be implemented as part of the proposed "package" to ensure that an appropriate balance between the interests of the general pool and the individual creditor. There is a risk, if one recommendation is implemented but not the other, that this balance will not be struck.

VOIDABLE TRANSACTIONS, PONZI SCHEMES AND OTHER CORPORATE INSOLVENCY MATTERS VOIDABLE TRANSACTIONS		
	Other issues relating to voidable transactions and other recoveries	
6	(a)	**What are your views on the other changes to the voidable transaction regime and other recoveries recommended by the Insolvency Working Group in Chapter 2? (recommendations 3-11)**
	R3 1. We agree that the two year period of vulnerability for clawbacks for unrelated party transactions at undervalue should be retained. **R4** 2. We agree that the vulnerability period for all clawbacks under ss 292, 293, 297 and 298 of the Act should be standardised and set at four years where the debtor company and the creditor are related parties. **R5** We agree that the definitions of "related creditor" and "related entity" in ss 245A and 239AM of the Act should also be used for determining whether a party is a "related party" for the purposes of all recoverable transactions, charges and securities. The objectives underpinning s 245A of the Act and the clawback sections are aligned. **R6** 3. We agree that the presumption of insolvency regarding transactions and charges in the six months prior to the commencement of a liquidation should be retained. 4. This presumption often forms an important part of the liquidator's recovery options and reflects the equal sharing principles underpinning corporate insolvency law in New Zealand. In our experience, it often reflects commercial reality. It is consistent with the Australian position. **R7** 5. We agree that the deadline for liquidators to file claims in the High Court under ss 292 to 299 of the Act (one of the factors to balance in these amendments) should be reduced from six to three years. The combination of a six year limitation period with a two year clawback created significant commercial risk for businesses. 6. This should assist in reducing business uncertainty. Further, as there is not necessarily a "wrong" to be rectified in liquidation proceedings	

as there may be with general proceedings subject to normal limitation periods, a reduced time period can be justified.

7. The IWG should consider and consult with liquidators as to whether three years is a sufficient time generally for liquidators to gather information and then decide whether or not to file a claim. In most circumstances we would anticipate that three years would be sufficient time and if exceptional circumstances arose, then R8 could be utilised. This consideration and engagement is important because if the time period allowed is too short, resulting in numerous applications for extensions, it would undermine any efficiency and certainty created by the reduction in time period.

R8

8. We consider that specific guidance should be included in the Act as to how the discretion is to be exercised, including relevant factors to guide that discretion. Those factors may include aspects of the payment being claimed (ie balancing creditors' rights against the party receiving the money), and aspects of the liquidator's application (ie whether the liquidator can point to some fact that excuses their out-of-time application, for example delays resulting from the conduct of the creditor or poor record keeping by the debtor company).

R9

9. We might support this recommendation (that a defence should be added for a creditor with a valid security interest who can demonstrate that there was no preference at the time they received payment) depending on what is implemented. The purpose and scope of this defence are unclear, as it is unclear what is meant by "valid security interest" (while a PMSI is mentioned, it appears likely that this would also incorporate unperfected security interests), and in particular whether it is intended to apply to both fully and partially secured creditors.

10. It is well settled that a payment in discharge of a valid security cannot constitute a preference. A common law defence already exists, as provided in *Grant v BB2 Holdings Limited* [2014] NZHC 2504 (subject to exceptions, in particular that payments do not exceed the value of the security).

11. If the scope of this defence is to apply to partially secured creditors, this will be a reversal of the common law position. It would also contradict policy considerations ("it would be absurd and contrary to normal commercial practice for a partly secured creditor to treat its

		security as reduced on a payment by the debtor company": *Grant v BB2 Holdings Limited* [2014] NZHC 2504 at [41]). **R10** 12. We agree that by removing the subjective intention element in s 292(4B) of the Act, administration costs should be reduced as the process should be a simple net-off. 13. We also agree that this recommendation aligns with the equal sharing principles that underpin insolvency law in New Zealand and overseas, as creditors who are subject to clawback will still be able to prove for their debt in the liquidation and share equally in the company's losses.
6	**(b)**	**Are the recommendations likely to have a material impact on the total amount of funds that liquidators would be able to recover under the voidable transaction for the benefit of creditors and, if so, how?**
		1. Several of the recommendations (including R3 and R6 as they are simply retention of the status quo) would not affect the total amount of funds that liquidators would be able to recover. 2. R4 has the potential to have a material impact on funds able to be recovered but only in situations involving, transactions that have been manipulated, for instance, the international movement of assets in order to defeat local creditors. 3. Conversely, R7 should not have a material impact on liquidators being able to recover funds for the benefit of creditors, as they will be incentivised to move quickly to file within three years. A faster recovery will improve outcomes for creditors. 4. Any reduction in recovery must be considered in light of the costs saved by unsecured creditors of having a more certain voidable regime, whereby liquidators are less likely to pursue speculative or frivolous claims.

PROCEDURAL ISSUES	
8.	**(a) What are your views on the procedural changes proposed by the Insolvency Working Group in Chapter 3? (recommendations 12-15)** **(b) In regard to recommendation 13 (content of liquidator's notice to set aside transactions) what standard and basic (additional) information should a liquidator's notice to creditors under section 294 provide and why? How would the creditor receiving the notice benefit from receiving this additional information and what would be the costs to the liquidator in providing the information?**
	R14 1. We agree with the recommendation at R14 that the clawback period should commence from the date of the appointment of the voluntary administrator, if the creditors decide to appoint a liquidator at the "watershed meeting". We agree with the reasoning set out in the Report. This enables the position of creditors to be protected as at commencement of voluntary administration. **R15** 2. We agree with the clarification at R15.
Ponzi schemes	
10.	**What are your views on the possible changes to the Property Law Act 2007 outlined by the Insolvency Working Group to aid the recovery of funds (adding a Ponzi presumption and a good faith defence)? (recommendation 16(a))**
	1. We note that the IWG recommended that the Government assess the need for any changes after the Supreme Court released its decision in *McIntosh v Fisk*. 2. Based on the decision, we do not consider that any amendments to the Property Law Act 2007 ("**PLA**") are required in the context of a "Ponzi scheme". The Supreme Court decision has provided clarity as to how subpart 6 of Part 6 of the PLA (and the voidable transaction regime in the Act) is to respond to a Ponzi scheme. 3. Finally, we consider that following the enactment of the Financial Markets Conduct Act 2013 ("**FMCA**"), the Financial Markets Authority ("**FMA**") has a number of powers available to prevent, or catch, Ponzi schemes. The FMCA is relatively new legislation, and we suggest that if a legislative response to Ponzi schemes is required, such response is best considered in the context of the FMCA and taking into account

		the views of the FMA as to the need for, and scope of, such reform (if any).
Other corporate insolvency issues		
11.	**(a)**	**What are your views on the other corporate insolvency law changes proposed by the Insolvency Working Group in Chapter 5? (recommendations 17-30)**
		R17 1. We agree with the IWG that the definition of 'secured creditor', for the purposes of Part 16 of the Act , should be amended to include all creditors holding a security interest as defined in the Personal Property Securities Act 1999 ("**PPSA**"). 2. The definition of 'secured creditor' under the PPSA appears to capture a wider range of creditors than the definition of 'secured creditor' under the Act. In principle, this recommendation would bring an end to the inconsistency between Part 16 of the Act and the PPSA. It should also end uncertainty arising from different approaches taken by the courts in relation to each definition, resulting from this inconsistency. **R18** 3. We do not agree that unsecured creditors should be the only beneficiary of recoveries from reckless trading claims 4. If implemented, the recommendation would remove the protection that the reckless trading duty provides for secured creditors and the incentive that may currently exist for secured creditors to bring a reckless trading claim against the directors. The duties in s 135 potentially protect secured creditors (who are affected by reckless trading if they hold a GSA) together with other classes of creditors. A blanket removal of this duty from security requires careful consideration. 5. The Report states that recommendation 18 would bring New Zealand into line with the Australian position. While there is some similarity between s 588Y of the Corporations Act (Cth), s 588Y of the Corporations Act relates to incurring debt when insolvent or likely to become insolvent. If amendment is to be considered a careful analysis of each duty is required. There may be other means to achieve a similar outcome, including the ability to improve recoveries for creditors who fund liquidator claims (thereby incentivising those who have suffered loss).

		R23 6. We support the IWG's recommendation permitting electronic communication between liquidators and creditors. Given the developments in technology and the reliability of email software, we consider that this is an appropriate and timely amendment. In principle, this recommendation should result in the timely provision of information to creditors (on a widely used medium) at a lower cost to insolvency practitioners, meaning a greater recovery for unsecured creditors. 7. We consider it is important for to strike the appropriate balance between increased efficiency and the obligations of an insolvency practitioner to adequately inform creditors. We suggest clarification, for instance, as to whether the creditor must provide the email address directly to the insolvency practitioner in order for it to be used, or whether email addresses listed on a creditor's website or in a directory may constitute an email address "obtained...from the creditor". **R27** 8. We share the IWG's view that PAYE falling due for payment after the date of liquidation (or receivership) should be treated the same as PAYE that is overdue as at the date of liquidation (or receivership). We are not aware of any compelling basis for treating PAYE differently based on when it falls due.
11	**(b)**	**What are your views on allowing liquidators to obtain, by right, certain information from third parties without having to go to the High Court? (recommendation 20 and page 48) What are the costs involved in seeking an order from the High Court? Does the High Court routinely approve such requests?**
		1. We suggest the IWG consider the compliance cost to parties holding records, such as banks and solicitors. We suggest the IWG also consider the risks to those parties in making disclosure without the certainty of a court ruling in support, in light of statutory, employment and contractual obligations relating to information of individuals, employees and contractual counterparties. The commercial interests of the recipient of such a notice should also be considered.
11.	**(d)**	**What are your views on establishing a new preferential claim for gift cards and vouchers? (recommendation 25 and pages 51-52)**
		1. We are not aware of a compelling principled basis justifying priority for gift card/voucher holders and therefore oppose this recommendation. If this recommendation were implemented, insolvency practitioners

		would face disproportionately large administrative expenses in respect of relatively low value claims.
	2.	In light of the current consumer pressure to extend expiry periods or remove expiry dates entirely from gift cards and vouchers, we suggest that the recommendation could have a greater impact than perhaps currently foreseen.
11.	**(e)**	**What are your views on the recommendation to limit the preference claims of the Commissioner of Inland Revenue and the Collector of Customs to six months prior to the date of the commencement of the liquidation? (recommendation 26 and pages 52-53).**
	1.	We support placing a limit on the preference claims of the Commissioner of Inland Revenue and the Collector of Customs, however we suggest the IWG consider a period of four months prior to the date of the commencement of the liquidation. A period of four months would bring these preference claims into line with the four month limit on employees' preferential claims.
12.	**(c)**	**How important is it for New Zealand's insolvency regime to be aligned with the Australian regime?**
	1.	We consider that it is generally desirable for there to be consistency (within justifiable limits) between the Australian and New Zealand regimes.