Simpson Grierson

Submissions 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

Questions for submitters on Report No. 2 ("Report")	
(*Note: references to paragraphs are to paragraphs in the Report, and references to the* **Reports** *are to both reports of the Insolvency Working Group*)	
Chapter 1: Voidable Transactions	
1	We partially agree with the assessment by the Insolvency Working Group (**IWG**) of the impact of the Supreme Court's decision in *Allied Concrete v Meltzer* on New Zealand's voidable transactions regime (paragraphs 32-34). We agree that because s 296(3)(c) will be met in almost every instance, the defence can now more easily be met by creditors in that they only have to prove two elements, rather than three. However, the defence is infrequently proven by creditors, particularly given the relatively low threshold of the "suspicion test" in s 296(3)(b) (introduced by the Companies Amendment Act 2006, and which represents a lower threshold than the "good faith" element in s 296(3)(a)). While we agree as a matter of policy that the "gave value" component of s 296(3)(c) should be repealed, we have not seen any evidence that the *Allied Concrete v Meltzer* decision has resulted in creditors being able to make out the statutory defence more frequently than before.
2	(a) We generally agree with the IWG's listed objectives of the voidable transactions regime (paragraph 53). (c) While all three objectives are important, we consider the objectives to be of descending importance.
3	(a) We partially agree with the IWG's views on the problems with the status quo (paragraphs 56-69). We agree with the second main problem identified by the IWG that the clawback period in New Zealand is too long having regard to the negative impact on commercial certainty. We do not agree with the IWG's view that the first main problem of the voidable transaction regime is that the collective interests of creditors are not adequately protected because they cannot be considered under the creditor's defence (para 56). Rather, the extent to which a creditor who has prima facie benefited from a voidable transaction, and therefore enjoyed a preference over the collective interests of creditors, should escape liability is a policy decision. Defences of this nature typically focus on whether there is something particularly deserving of the particular creditor's position to warrant an exclusion from the general rule. Accordingly, it is appropriate that the focus of the defence should be the individual creditor. The ease and extent to which an individual creditor will be able to satisfy the statutory defence effectively represents the balancing exercise by which the collective interests of creditors gives way to the individual creditor's interests. Individual creditors have the onus of proving the elements of s 296(3). While the Supreme Court's decision in *Allied Concrete v Meltzer* has resulted in the third element being otiose in almost every scenario, it has not altered the other two elements which a creditor was, and remains, liable to prove. Relevantly, in that regard, the "suspicion test" in s 296(3)(b) is frequently difficult for creditors to satisfy. The IWG's criticisms of the knowledge components of the statutory defence (commercial inefficiency, inconsistency with effects-based test, and excessive administration and compliance costs) are valid on a conceptual level, but the

	IWG does not recommend any alteration to those knowledge components. Ultimately, we consider that the knowledge components in s 296(3) are appropriate and are a necessary way to differentiate an individual creditor's interests from the collective group of creditors. In our experience, the relatively low threshold by which a creditor will fail the "suspicion test" means that individual creditor's interests do not frequently trump the interests of collective creditors. (b) In the context of the Report, there is only one other voidable transaction regime issue that we want to raise. We suggest that consideration should be given as to the necessity for liquidators to file in Court the original notice to set aside a voidable transaction or charge as is presently required by s 294(1)(a). The existing rationale for filing seems to relate to issues of supervision. However: (i) we would not expect a Court to review the notice unless the liquidator also makes a formal application to set the transaction aside; (ii) the proposed regulation of liquidators should result in more easily enforceable standards of conduct; (iii) the current requirement that notices be filed in Court can cause inexperienced creditors wrongly to infer that the Court is giving notice that the creditor must return the earlier payment; and (iv) there is a cost of requiring liquidators to file every notice in the High Court, and this no doubt also imposes a degree of administrative burden on the High Court – both cost and burden may be unwarranted.
4	(a) We support the package of changes recommended by the IWG in Chapter 1 (recommendations 1 and 2 and paragraphs 72-77), although we consider that the "specified period" under the Act should be reduced to one year, rather than six months as recommended by the IWG, and the "restricted period" retained. In our experience, we see instances in which an insolvent company ceases to trade, but a creditor does not apply to liquidate the company for more than six months. If the voidable transaction regime only applies for a six month period, then the collective creditor group will be disadvantaged from a liquidator being unable to examine the transactions in the period prior to the company being insolvent. The statistics below also support our conclusion that there is merit in having the specified period being longer than six months. (b) We agree with the IWG that recommendations 1 and 2 should be implemented as a package (paragraph 70). However, we would support either recommendation individually as well. In respect of the number and value of voidable transactions that we are instructed as solicitors to act on that fall within the specified period (but outside the restricted period), we were involved in 10 voidable transaction claims of that nature in 2016 with an aggregated value of $2.54 million, and we are currently involved in one claim this year valued at $75,000.
5	The recommendations attempt a fair balance, should increase certainty and fairness, and would involve minimal disruption to the wording and structure of the existing provisions. Despite numerous formulations being attempted in the last 25 years (as recorded in Annex 4), the current regime is still considered to be unsatisfactory. These recommendations are worth trying.

Chapter 2: Other issues relating to voidable transactions and other recoveries	
6	(a) We generally agree with all of the Chapter 2 recommendations (recommendations 3 – 11). In respect of each recommendation: • R3 – we agree. • R4 – we do not oppose the clawback period for related party transactions being extended to four years, although we are not aware of the existing periods being unduly short. • R5 – we agree. • R6 – we agree. • R7 – we agree. • R8 – we agree, but would see merit in the legislation prescribing the matters the Court may take into account. • R9 – we agree. • R10 – we disagree. The continuing business relationship rule was introduced to address the specific scenario where creditors operate a running account with a debtor company, recognising that in those circumstances a series of transactions cannot not be treated as isolated transactions having regard to the broader business relationship of the parties. The subjective intentions of the parties is a fundamental component of determining whether the credit relationship is operating on a running account (such that it is impossible to pause at any transaction without having regard to the surrounding transactions) as opposed to a sequence of independent transactions. • R11 – we agree. (b) We would not expect the Chapter 2 recommendations to have a material impact on the total amount of funds that liquidators would be able to recover from voidable transactions. Some of the recommendations may tend to swell the creditor pool, and others may tend to operate for the benefit of individual creditors – so there may be an off-setting effect across the suite of recommendations. (c) We agree that the limitation period for voidable transaction clawback claims should be reduced from 6 to 3 years (recommendation 7). In our experience, voidable transaction claims are infrequently initiated 3 years after the commencement date of the liquidation.
7	We agree with the IWG's view that the recommendations contained in Chapter 2 can be made with or without making the changes recommended in Chapter 1. However, our preference would be that they happen together.
Chapter 3: Procedural issues	
8	(a) We generally support the procedural changes proposed by the IWG in Chapter 3. In respect of each recommendation: • R12 – we agree. • R13 – we agree. • R14 – we agree 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 under s 239ABU(b) of the Act. Based on the same reasoning, we recommend that it should also apply if the Court appoints a liquidator during an

	administration under s 239ABU(a) of the Act. • R15 – we agree. (b) In regard to recommendation 13 (content of liquidator's notice to set aside transactions) we have no further comment on what information a liquidator's notice to creditors under section 294 should provide
Chapters 1-3: Voidable transactions and recoveries generally	
9	In respect of other issues with the voidable transaction and other recoveries regime that are not covered by Chapters 1 to 3 of the IWG's report, please see the attached schedule.
Chapter 4: Ponzi schemes	
10	The Supreme Court's decision in *McIntosh* v *Fisk* has provided little by way of guidance specifically relevant to Ponzi schemes. The treatment of Ponzi schemes raises different, and potentially more difficult, issues from the other mainstream issues considered in the Reports, and we suggest that Ponzi schemes be considered separately, outside of the Reports, rather than risking delay in the consideration and implementation of the other recommendations.
Chapter 5: Other corporate insolvency issues	
11	(a) In respect of the other corporate insolvency law changes proposed by the IWG in Chapter 5 (recommendations 17-30), other than those dealt with in paragraphs (b) to (f) below: (i) R17 – We generally support this change, but suggest that: • the definition would need to take account of the impact of s 23 of the Personal Property Securities Act 1999 (**PPSA**). A number of arrangements which are prima facie caught by the definition of "security interest" are nevertheless backed-out of the PPSA by s 23, particularly where involving transfers of accounts receivable. In other words, it is unsafe to import the basic definition of "security interest" without considering the impact on that definition of s 23; and • a careful review be undertaken of the broader Companies Act use of the definition, to minimise unintended outcomes. (ii) R18 – We do not support this recommendation. Reckless trading claims tend to affect the value of the whole business, and in particular its value as a going concern. A creditor with a general security interest, who has based its lending decisions on the value of the company as a going concern, will be exposed to losses in going concern value (as well as physical asset value) arising from reckless trading activities. Changes as to entitlements to the proceeds of reckless trading claims may have consequences for the availability of support or funding to pursue those claims. We note that the IWG seemed to focus on "*where directors of the debtor company (or interests associated with them) hold a general security agreement and the directors continue trading long after the company ought to have been liquidated*" (paragraph E21), however: • related party secured creditors are a special case; and • if it is the related party relationship of the secured creditor which is a concern, then that logically should be considered

under the related party transactions provisions, rather than as justifying a major change which will be to the disadvantage of all general security holders. We consider that there are already sufficient legislative provisions to address the mischief which the IWG is concerned with.

(iii) R19 – We support this recommendation.

(iv) R20 – We do not support this recommendation - see further below.

(v) R21 – We support this recommendation.

(vi) R22 – We support this recommendation – ss 303(2) and 308 are an unjustifiable anomaly (although we note that they are the subject of the recent Statutes Amendment Bill (No 2), so the Legislature may not share that view).

(vii) R23 – We support this recommendation.

(viii) R27 – We support this recommendation.

(ix) R28 – We support this recommendation.

(x) R29 – We support this recommendation.

(xi) R30 – We support this recommendation in principle.

(b) R20 – We do not support this recommendation. The powers afforded to liquidators under ss 261 and 266 of the Act are extremely broad. While it is appropriate for liquidators to be able to obtain company documents as of right under s 261, the privacy and property rights of third parties should not be eroded by liquidators being able to access non-company documents as of right. The existing position, whereby a liquidator can seek orders from the Court under s 266 requiring a person to disclose such documents and information, is appropriate. We suggest that broader public consultation of this recommendation would be appropriate prior to it being enacted

(c) R24 – We agree that clarification is required in respect of long service leave and also payment in lieu of notice (the latter arises as an issue on a regular basis).

(d) R25 – We have no objection, in principle, to the proposed priority for gift cards and vouchers. However, we see a number of practical issues arising from the proposal, which will need further consideration, including:

(i) to aid certainty (and perhaps minimise the risk of "gaming") the arrangements to which the priority will relate, both as to nature (gift cards and vouchers could be seen as just one subset of pre-paid, or loyalty arrangements), and counterparty (in respect of which, perhaps only unrelated parties being consumers), will need to be carefully defined;

(ii) receivers do not have the equivalent to a formal "call for claims" process as is available to a liquidator (including the important cut-off date mechanism – see regulation 13 of the Companies Act 1993 Liquidation Regulations 1994), so (given the typically bearer nature of gift cards and vouchers) receivers will need some means of achieving certainty – perhaps by means of a prescribed notice procedure and cut-off date;

(iii) whether an expiry date, whereby the priority only applies to gift cards and vouchers issued within a particular period prior to the appointment, should apply;

	(iv) as gift cards and vouchers typically cannot be exchanged for cash (but only for goods, the value of which includes the retailer's profit margin), should their face value for priority purposes be discounted? (e) R26 – We generally support the recommendation to provide a limit on the preferential claims to the Commissioner of Inland Revenue and the Collector of Customs, but would suggest that a longer period is appropriate (perhaps one year). The Commissioner and Collector have routine access to powerful information which should flag potential insolvency – for example, the failure to make PAYE and/or GST returns. Conversely, the Commissioner and the Collector should not be motivated to seek to liquidate companies prematurely (which would detrimental to business activity generally and the revenue functions of the Commissioner and the Collector). If a limitation is placed on the Commissioner's and Collector's priority status under the Seventh Schedule of the Act, we recommend that it be calculated by reference to the "commencement of the liquidation", which is to be defined to take into account the delay which may arise between a creditor filing an application to liquidate a company and the Court granting the application (as is the case, for example, under s 292 of the Act). We would further recommend that that definition apply to all other priority creditors under the Seventh Schedule whose priority is limited by a time period (see, for example, clause 1(2)(a)). The priority status of the Commissioner and the Collector perhaps requires consideration separate from these Reports. (f) R30 – We have no particular views on what aggregate information the Registrar could usefully publish. Provided the costs of compiling the information are not disproportionate, the collation and publication of information is sensible.
12	(a) We generally agree with the comments in paragraphs 173 to 177, however (with particular relevance to paragraph 176) after our recent experiences with administrations (including Solid Energy, Pumpkin Patch and Wynyard Group): (i) we could not endorse the IWG's assessment that *ipso facto* clause "*reforms are not needed in New Zealand*", and we suggest that such reforms be given serious consideration (and after wide consultation, given that they involve serious questions around the sanctity of contract) once the proposed Australian changes are public; (ii) similarly, our experiences with Solid Energy in particular suggest that some form of directors' safe harbour regime is worthy of further consideration; and (iii) there are a number of procedural aspects of Part 15A which do not operate well, or are not capable of being complied with, and ought to be reviewed separately from these reports. In the context of *ipso facto* clauses, we suggest that an interim position be considered whereby an equivalent of the "essential services" provisions of s 275 of the Act and s 40 of the Receiverships Act 1993 (**Receiverships Act**) is inserted into Part 15A of the Act. (b) In our opinion New Zealand's insolvency regime generally meets the OECD's objectives outlined in paragraph 173.

	(c) In our view, it is generally desirable for New Zealand's insolvency regime to be broadly aligned with that of Australia, but that there will always be areas of justifiable exceptions.
13	We attach a schedule with details of other changes to corporate insolvency law not covered in the Reports that could be considered. We would be happy to expand upon them.
Chapter 6: Implications for personal insolvency law	
14	Subject to our comments above in respect of each of the recommendations, we agree that if recommendations 1-13, 17 and 24-27 were implemented, these changes should also be made to the Insolvency Act 2006. Please see our comments above in respect of recommendation 15.
Other comments	
15	We have no other comments on the Report, and would like to express our further thanks to the members of the IWG for their efforts.

Schedule

(other changes)

1. Debt remission income tax – The prospect of a tax bill, arising from a debt write-off, can scuttle an otherwise desirable restructuring. The need to protect the tax base from improper dilution is accepted, but where the debt remission rules effectively prevent genuine restructurings then it is suggested that the net is cast too broadly. The Solid Energy restructuring is a classic example of where the remission rules could have killed-off a restructuring which has had demonstrable benefits for employees, creditors and whole communities.

2. Restoring the pre-*Burns & Agnew* position - The current position is significantly different from the pre-PPSA position, and represents a significant windfall for the Commissioner – one possibility is simply to replace "accounts receivable" in the relevant parts of Schedule 7 to the Act, and section 30 of the Receiverships Act, with something like "accounts receivable in the nature of book debts".

3. Introducing into the Voluntary Administration regime an equivalent to Part 14's 10 day attack limitation period (s 232(4)), so that there is a limited period within which to attack the outcome of a watershed meeting. On-going uncertainty during the DOCA implementation period is disruptive.

4. Reducing the importance of creditor classes in Part 14 compromises, to match the accepted position applying to Voluntary Administrations – the potential impact of classes currently inhibits the use of Part 14, and there seems no logical reason why Parts 14 and 15A should operate so differently in this regard.

5. Expanding the definition of "mortgage debenture" in s 125 of the Property Law Act 2007, so that receivers can exercise immediate and full powers of management of land owned by non-bodies corporate (such as partnerships and trading trusts) without having to have an expired notice. The current limitation of this to bodies corporate fails to reflect the reality of unincorporated business structures. Care would need to be taken to preserve the current position regarding consumers and other equivalent non-trading entities.

6. Section 239ADH of the Act (*administrator liable for general debts*) is being read very widely (which has caused unnecessary problems), and could usefully be more specific – for example, inserting "purchase price for" at the beginning of (1)(b) and (c), and "fees, rent and other periodic payments in respect of" at the beginning of (1)(d).

7. The susceptibility of DOCA-based transactions to the voidable transaction regime could be clarified, by deleting the requirement in s 239ACB(1)(b) of the Act that they be "carried out by the deed administrator" – if they are already "specifically authorised by the deed of company arrangement" then it should not matter who the transactions are carried out by.

8. Streamline the enforcement provisions relating to goods under the Property Law Act 2007 and PPSA (including to remove the current duplication between the two Acts).

9. Consideration be given to whether the interpretation given to s 95 of PPSA (which deals with the priority afforded to recipients of debtor-initiated payments) by the Supreme Court in *Stiassny v CIR* is consistent with the policy of that section. That is, does s 95 need to apply to distributions made in an enforcement

scenario (e.g. by a receiver or liquidator) in order to "facilitate ordinary trade and commerce"?

10. Consideration be given to giving legislative effect to the judgment of Elias CJ and O'Regan J in the deadlocked Supreme Court decision in *Gilbert* v *Body Corporate 162791* – on one characterisation, the outcome of this case is to introduce a distortion of the receivers' personal liability regime (which is likely to have unintended consequences in other situations) in order to fix a gap in the unit titles regime.

Simpson Grierson

Submissions on whether to introduce a Director Identification Number

As arising from the reports of the Insolvency Working Group

1	**Are you aware of the issues identified? Please describe the extent to which you think they are a problem.**

In our submissions in response to the Insolvency Working Group's (**IWG**) Report No 1, we commented (at point 14) as follows:

> *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.*

We have not changed our views.

We also draw to the Ministry's attention the apparent "lukewarm response of the Australian government" to proposals for a director identification number (please see http://murrayslegal.com.au/blog/2017/05/08/governments-response-to-the-2015-productivity-commission-report-business-closure/ and subsequent publications from the same source referring to Report 2 of the IWG).

2	**Are there any other issues that we have not identified? If so, please describe them and provide evidence if available.**

As above.

3	**Do you think a director identification number is the best way to address the issues identified?**

We remain of the view that the extent, and nature, of the issues identified do not warrant the introduction of a director identification number regime.

4	**What are your views on the proposed objectives for assessing whether to introduce a director identification number?**

As above.

5	**What are your views on the benefits and costs of a director identification number? Are there any other benefits, costs or risks?**

As above.

6	**Do you support the introduction of a director identification number?**

As above.

7	**If a director identification number is introduced, what are your views on how a number could work?**

As above.

8	**Do you have any other comments?**

No.