Submission

by

Business|NZ

to the

Ministry of Economic Development

on the

Insolvency Law Review

Tier Two Consultation Questions

29 June 2001

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This submission is presented by Business New Zealand incorporating the regional founder members of the organisation and affiliated organisations. The organisation represents business and employer interests in all matters affecting the business sector.

Members of Business New Zealand

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INSOLVENCY LAW REVIEW

TIER TWO CONSULTATION QUESTIONS

SUBMISSION BY BUSINESS NEW ZEALAND

29 JUNE 2001

1. INTRODUCTION

1.1 Business New Zealand is the leading national organisation representing the interests of New Zealand's business and employing sectors comprising some 76,000 individual enterprises. Business New Zealand champions policies that would transform and accelerate the growth of high value added goods and services to significantly improve the prosperity of all New Zealanders.

1.2 In general, Business New Zealand supports the thrust of the Law Commission's advisory report *Insolvency Law Reform: Promoting Trust and Confidence*. We agree that a strong insolvency system should act as an important pillar of support for commerce and that it has a critical role to play in fostering economic growth and competitiveness. It is vital that the insolvency law system should have the trust and confidence of all participants.

1.3 In particular, we make the following key points, which are expanded upon in the answers to the consultation questions posed by the Ministry of Economic Development in its letter of 11 May:

- We agree that the State's enforcement role would be enhanced through the design of a new regulatory framework and more efficient utilisation of all public enforcement agencies.
- We agree with the proposal to establish an Inspector General of Insolvency office.
- We strongly support consumer education and budgetary advice receiving greater prominence in the secondary school curriculum.
- We agree that a targeted business rehabilitation regime, as proposed by the Law Commission, should be introduced.

- We agree that it would be appropriate to synthesise Part XIV of the Companies Act 1993 and Part XV of the Insolvency Act 1967 and that Part XV of the Companies Act should be repealed.
- We agree that the statutory management regime should only be retained as a measure of last resort and only implemented in exceptional circumstances.
- We agree that a single generic insolvency statute should be enacted.

1.4 The remainder of this submission contains Business New Zealand's answers to the consultation questions. We note that there was a minor problem with regard to the paragraph references contained in the consultation questions. While they were correct for the advisory report posted on the Law Commission's website, the hard-copy version contained different paragraph numbers. This caused some confusion.

ANSWERS TO CONSULTATION QUESTIONS

Role of the State

State Role in Enforcement

1. Is the State performing its enforcement function adequately? If not, what enforcement tasks are not being performed adequately?

   There certainly appears to be concern about the State's enforcement function and this concern is backed up by anecdotal evidence and statistics that show a substantial fall in the number of prosecutions carried out. It has been argued that as a result there is a lack of business confidence in the State's performance in this area.

2. What have been the consequences of any inadequate enforcement?

   It is argued that a lack of enforcement action has lessened the deterrent to irresponsible and undesirable behaviour. It is therefore likely that some individuals who should not be in business are not being removed from the system, so increasing the risk for other responsible businesses.

   The report also states that a strong insolvency system acts as an important pillar of support for commerce and therefore has a critical role in fostering growth and competitiveness. We agree that a lack of confidence and trust in the insolvency regime would undermine the system and could have negative impacts on the economy.

3. Do you consider that the State's current enforcement of insolvency law should remain the same or be altered? Should any particular agency or agencies have their role(s) changed?

   We agree that action needs to be taken to restore trust and confidence in the State's enforcement role. The proposal to design a new regulatory framework

would appear to be justified (option (b)) and we believe it would be complemented by more efficient utilisation (particularly through improved co-ordination) of all public enforcement agencies (option (c)).

4. What are your views on the three options for State enforcement identified in paragraph 157 of the Law Commission's report?

We believe that options (b) and (c) are both worth pursuing. The status quo does not appear to be working and it might take some time for the National Enforcement Unit to have the desired impact. We also note the doubts the Law Commission has over whether the Unit would on its own significantly improve market confidence.

5. Are there any better options?

Unsure.

6. What are your views on the role of the Court in insolvency?

As the report recognises, there is a concern that New Zealand, being a small country, does not currently have a large enough pool of specialist practitioners and judges to deal adequately and in a timely fashion with the current Court workload, let alone were courts to be given the added responsibility of dealing with difficult rehabilitation and statutory management cases.

7. What are your views on the two options identified in paragraph 169 of the Law Commission's report? Are there any better options?

We believe that some specialisation would be useful and appropriate and would help assist the concerns expressed in the answer to the previous question (i.e., we prefer option (b)). Of course, the feasibility of this option needs to be assessed given New Zealand's small size.

State as Regulator

8. Do any problems exist with the current appointment procedures for insolvency practitioners in New Zealand?

   The Commission has identified some problems with the current regime, such as concerns over whether there are adequate quality controls for insolvency practitioners, the imposition of different standards, and information asymmetry (see paragraph 171 of the report). These appear to be reasonable concerns.

9. If problems exist, are these issues, at their root cause, to do with appointment procedures or the regulation of practitioners? Is there a non-regulatory solution to any issues that exist?

   Appointment procedures ought to be an integral part of the regulation of practitioners. Most regulatory regimes deal with entry to as well as exit from a system.

10. Should the current regulatory regime be amended, as recommended by the Commission in paragraph 177?

    We believe that the State, rather than private liquidators, should bear the costs where there are no assets.

11. Do you agree with the Commission's recommendations concerning directors in paragraphs 173-175?

    We agree that the inconsistencies between the Insolvency Act 1967 and the Companies Act 1993 should be addressed through synthesising the provisions of the two Acts.

    We agree that directors should be able to be examined publicly before a Master of the Court where there are concerns about irresponsible commercial behaviour.

We also agree that the Court should have the power to disqualify a director from involvement, directly or indirectly, in the management of a business or company after the hearing of evidence from the director at a public examination.

All of these recommendations would assist in restoring commercial trust and confidence in a robust and transparent insolvency regime.

State as Office Holder

12. Should the State have an exclusive domain over bankruptcies? Does the State have a role to play in providing administration for cases where there is no economic incentive for private practitioners?

No and yes, respectively.

13. What are your views on the recommendation, identified in paragraph 179 of the Commission's report, that the State should undertake the role of administrator in an assetless bankruptcy but leave the administration of other liquidations and bankruptcies to the private sector? Are there any better options?

We agree with this recommendation.

A New Regulatory Authority

14. What are your views on the proposal to create an Inspector-General of Insolvency office as identified in paragraph 193 of the Commission's report? What other options may exist?

We agree with this proposal. It would be particularly useful in providing more transparency for funding of enforcement.

15. Are there any better options for addressing any of the problems identified by the Commission? Should the State address each of these problems?

No.

16. What are your views on the addition of a new business unit to deal with the tasks that could be undertaken by the Inspector-General?

We support this suggestion. It would improve transparency and accountability.

17. What are your views on the funding options listed in paragraph 195? Are there any better options?

These options would seem to be appropriate.

State as Educator

18. What are your views on the suggestions made by the Commission in paragraphs 208-210?

We strongly support consumer education and budgetary advice receiving greater prominence in the secondary school curriculum. However, while we note that the Retirement Commission developed material for inclusion in the curriculum, there has been a poor take-up by secondary schools. The issue of take-up by schools would need to be addressed. It may be better to have an all-encompassing 'finance' course, which could cover consumer education, budgetary advice, superannuation, and investment issues.

19. Should the State provide financial counselling services to consumer debtors (paragraph 211)? Should the State fund providers of financial counselling services to consumer debtors? What other options may exist?

We believe that the State's role in this area should be promotional rather than as a funder and provider of such services. There are already many private sector charitable organisations involved in counselling of consumer debtors.

Business Rehabilitation

Problem Definition

20. Do you agree with the Commission that no problem exists because of the lack of a rehabilitation regime in New Zealand?

It would appear from the consultation undertaken by the Commission that this view may well be justified. There were concerns expressed by members in the past (particularly in the wake of the 1987 Sharemarket Crash), but not in recent times.

21. Do you agree with the Commission that a rehabilitation regime be introduced? What are the risks (both fiscal and non-monetary) associated with introducing or not introducing a rehabilitation regime?

Providing such a regime is targeted, as proposed by the Commission, we would support it being further considered. The risks of adopting a rehabilitation regime (such as a strict entry criteria possibly dissuading companies from entering rehabilitation at an early stage) will need to be balanced with the benefits of having a regime in place (such as the provision of incentives for debtors to face up to creditors early) as well as the continued risks of maintaining the status quo.

22. Do you believe that the lack of an automatic stay or moratorium (mandatory suspension of actions and proceedings against the property of the entity) against all creditors in the current statutory procedures prevents companies from being rehabilitated?

Any response to this question can only be given on the basis of surmise, but there have probably been some situations where this has been an issue.

23. Do you agree the factors taken into account by the Commission are appropriate in deciding whether to introduce a rehabilitation regime (paragraph 216)? Should other factors (e.g., the impact of any changes on the cost of credit) be taken into account?

The list in paragraph 216 seems reasonable, but we also agree that the impact of any changes on the cost of credit is important – we note that the Commission has appeared to take that issue into account in its assessment of the United States' Chapter 11 regime and dismissal of its provisions being copied by New Zealand.

Informal Workouts

24. Should the Government encourage informal workouts and, if so, how?

Yes, in principle. The issue is how it could do this. Tax incentives have been identified as one option. However, the costs (both fiscal and compliance costs) of any tax incentives would need to be carefully assessed, as would the important issue of the precedent such a move would create for tax concessions across the wider economy.

25. Do you think the provision of a tax incentive to debtors would encourage compromises with creditors? Is this likely to lead to an increase in collective compromises? What other benefits may flow from this recommendation?

Tax incentives would probably encourage more compromises than the current system does, but the comments above in answer to question 24 would equally apply.

Current Regulation

26. What are your views on the proposals to synthesise Part XIV of the Companies Act 1993 and Part XV of the Insolvency Act 1967, and the repeal of Part XV of the Companies Act 1993? In particular, can the procedural requirements of Part XIV be improved? Is the operation of Part XV of the Companies Act uncertain? Should the legislation ever allow compromises to be imposed on creditors where a significant number do not agree? Should Part XV be repealed?

    It is appropriate to synthesise Part XIV of the Companies Act 1993 and Part XV of the Insolvency Act 1967 and to consider repealing Part XV of the Companies Act 1993.

Law Commission's Proposed Regime

27. What do you think are the advantages and disadvantages of this regime? Do you agree with the Law Commission's entry criteria? Why?

    Paragraph 287 of the Commission's report sets out reasons in support of a rehabilitation regime targeted at larger businesses. If it were open to all businesses it would be probably be too difficult and costly to administer (especially for a small country like New Zealand with limited court resources). Therefore, while it would appear that the Commission's proposed entry criteria are quite strict, this might be necessary in the New Zealand context.

28. How important is the issue of cost in the design of the regime? Would the cost of entry into the Commission's proposed regime be prohibitive? How can the costs of reporting requirements and court applications be balanced with accessibility issues?

    Cost and efficiency of the rehabilitation regime are very important factors. The cost of entry into the proposed regime may be prohibitive to many small

businesses, but the regime should be more efficient in targeting larger businesses.

29. Would greater accessibility to rehabilitation procedures encourage debtors to address financial difficulties as early as possible?

Perhaps, although this thinking relies on the assumption that debtors (and creditors) would act rationally. This is not always the reality, as the discussion paper itself recognises. For example, it cannot be assumed that debtors will have kept accurate accounting records as paragraph 253's first bullet point supposes. It is also likely that many debtors will still wish to continue trading in the hope that they could trade their way out of their difficulties.

30. Who should be able to initiate the rehabilitation process? Should creditors, as well as the debtor, be able to initiate the process?

The assumption appears to be that only debtors would initiate rehabilitation processes. There would be value in considering whether both debtors and creditors would be able to initiate this process.

31. What are the risks attached to the introduction of a stay against creditors, as recommended by the Commission? Should secured creditors retain any powers during the rehabilitation process? In what circumstances might a secured creditor be able to veto a rehabilitation?

There would be a risk that the cost of credit might increase in the longer term as creditors build this consideration into their cost structures. However, without a stay, some creditors might prematurely 'pull the plug', so defeating the purpose of rehabilitation.

32. Do you agree with the Commission that a 14-day stay, which may be extended for a further 14 days, is adequate? Why?

It would be sufficient to enable some breathing space while initial assessments and decisions are made, with the possibility of extension should particular circumstances warrant this.

33. Who should control the debtor entity during the stay? Should there be an impartial administrator, or should management of the company continue on? What checks and balances might be put in place?

If there is fraud involved, then obviously the management of the business should not take any further part in the running of the enterprise. However, for those businesses run by honest and competent people, we agree that the existing management should continue, but under the supervision of an impartial administrator.

34. How extensive should the powers of the impartial administrator be? What powers and duties should the management of the debtor have during the stay? Do you agree with the Commission that decisions by management should be subject to veto by the administrator? Do you think that management should be prohibited from using the debtor's existing capital?

We agree with the suggestions of the Commission, including that the administrator should have a right of veto over management decisions.

35. What other statutory requirements would be necessary for the duration of the stay?

No other statutory requirements would necessarily be required.

36. What other options may exist to deal with this problem? What would be the key features of an alternative regime?

Retention of the status quo.

Corporate vs. Business Rehabilitation

37. Do you agree with the Commission that less legislation would be required if it is the core business, and not the corporate shell, that is the subject of rehabilitation?

Yes.

38. Do you agree with the Commission that the risk of inconsistency in legislation would be reduced by their recommendation? Would this help ensure consistent policy?

Yes, all things being equal. Evidential rules may, however, be difficult to comply with.

39. What are the implications of the Commission's recommendation for individuals in business? What risks would be borne by sole traders and other individuals in business if a general business rehabilitation scheme were adopted? Are there any other risks?

Presumably sole traders would rarely be affected since the proposal is that the rehabilitation regime be targeted primarily at larger businesses. Sole traders may, however, be reluctant for their operations to continue following insolvency given they bear personal liability.

40. Would these risks be outweighed by the benefits outlined by the Commission?

Yes, probably.

Statutory Management

Problem Definition

41. If there were no Corporations (Investigation & Management) Act ('CIMA'), would there be situations that would be unable to be dealt with under current companies and insolvency laws, including, for example, Parts XIV and XV of the Companies Act? If so, what are these situations? Why can't these situations be dealt with under existing company and insolvency laws?

As the report notes, New Zealand has a long history of statutory management legislation. However, the Commission identifies a number of criticisms of the statutory management process under the CIMA and it is particularly interesting to note that no other country appears to have a similar regime. It may well be that CIMA aside, current companies and insolvency laws are entirely adequate in the current New Zealand context.

42. What are the critical features of a procedure such as statutory management that enables it to address these features?

It should enable quick action to be taken when a corporation is operating fraudulently or recklessly, so protecting investors, and it enables a corporation to be rehabilitated or liquidated in extraordinary circumstances and groups of corporations to be dealt with as a whole. However, as the report points out, statutory management in New Zealand has been seen principally as an insolvency measure.

43. Do these features have any corresponding disadvantages – for example, a power to intervene quickly may preclude certain procedural safeguards?

We agree that power to intervene quickly could have a detrimental impact in terms of precluding some safeguards. But in some instances this could be justified, especially if it is in the wider public interest or an emergency.

44. Could these features be incorporated within mainstream insolvency and companies law with general application, such as a rehabilitation procedure, or should they continue to have more limited application?

Yes, provided they were included only as a measure of last resort and only implemented in exceptional circumstances.

45. How is the CIMA regarded internationally? What implications, if any, does that have for the economy?

Unsure about how the CIMA is regarded overseas. However, since 1984 economic reforms, developments and trends have resulted in New Zealand becoming increasingly part of a global economy. Over recent years many New Zealand companies have moved their head offices offshore (particularly to Australia) and many more overseas-owned companies have established businesses in New Zealand or invested in New Zealand businesses. Therefore, international implications are obviously very important to consider.

Application of Statutory Management

46. If statutory management is retained, in what situations do you consider it appropriate that a statutory manager should be appointed?

We agree with the Commission that it should be preserved as a remedy of last resort and in cases where the affairs of a corporation cannot be dealt with by any other insolvency regime or if the public interest requires it to be used. The 'public interest' needs to be defined however – we agree with the Commission that it should be confined to an emergency situation or essential industry.

47. Are those situations able to be dealt with in another way?

Through a rehabilitation regime?

48. What do you consider should be the criteria on which such a procedure could be invoked?

Statutory management should be invoked as a last resort and in extraordinary circumstances where it appears that the affairs of the corporation cannot by dealt with by any other insolvency regime. The procedure to invoke statutory management should reflect this.

49. Should operating a corporation fraudulently and recklessly continue to be criteria for appointing a statutory manager?

The Law Commission report (paragraph 362) states that its proposed statutory management regime would be targeted at situations where there is evidence to indicate that there has been dishonest, reckless, or incompetent management, which has reduced a business to chaos. This would seem to be an appropriate basis for the appointment of a statutory manager.

50. Would the introduction of a rehabilitation procedure with a stay against creditors leave any scope for statutory management? If so, what situations would still need to be addressed?

Yes, for those extraordinary cases for which there appears to be no appropriate and conventional insolvency regime.

Commencement

51. Would the Court be a more appropriate body to decide whether a statutory manager should be appointed?

This would be a more transparent and accountable process and, providing both sides had the ability to present their evidence, it would also be less open to concerns about political interference. There would, however, be concerns about the time that would be involved in getting a court hearing.

52. How long should it take to appoint a statutory manager? Do you think a court process will enable applications to be heard within that timeframe?

It should be able to done urgently. However, see the above answer to question 51 with regard to concerns over whether the Court would be able to hear and decide applications sufficiently promptly.

53. Would this recommendation, aimed at minimising the disadvantages of the existing statutory management system as an extraordinary insolvency procedure, undermine the ability of the process to deal with situations of fraud?

Not necessarily. The Law Commission report (paragraph 362) states that its proposed statutory management regime would be targeted at dishonest, reckless, or incompetent management, which has reduced a business to chaos. As already noted, this would seem to be appropriate.

54. Who should be able to make application to the Court for appointment of a statutory manager?

Any interested party.

55. Who should be able to be heard in such an application?

Any interested party.

56. Should applications for the appointment of a statutory manager be dealt with in a confidential manner?

Unsure. Can see merits behind both arguments, although generally speaking openness is usually preferable.

Role of the Statutory Manager

57. Does the CIMA currently provide sufficient guidance to a statutory manager on the purpose of their role?

Yes.

58. What do you consider the role of a statutory manager should be? Why? Are there any other options? What are they?

Initially a statutory manager's role should be to investigate and take moves to bring order to the affairs of the corporation and protect the interests of creditors. Subsequently, if deemed necessary, statutory managers should also be able either to rehabilitate or liquidate the corporation.

59. Should the statutory managers be required to report? If so, to whom and when should they report? Should statutory managers be required to hold a meeting with creditors?

Statutory managers should be required to report to an independent body. We would also support requirements for there to be a meeting with creditors.

60. Should there be an advisory committee appointed to assist statutory managers? If so, what should the role of that committee be? Who should appoint such a committee?

Yes, as recommended in the Securities Commission's 1992 report.

Costs

61. How should the costs of statutory management be dealt with? Who should be responsible for approving costs?

As suggested by the Commission, the cost-recovery regime should be agreed to between the statutory manager and the advisory committee. The arrangement would be sanctioned by the High Court.

Duration and Termination of Statutory Management

62. Should the appointment of a statutory manager be time-bound? Why? If so, what do you consider to be an appropriate length of time? Why?

Yes. The Law Commission's proposal of a three-month initial period, able to be extended for a further three months, would be appropriate. It is important for a time limit to exist with the option for extension if the circumstances warrant this.

63. Who should be able to make application to the Court for an order terminating a statutory management? What should be the criteria for such an order?

Any interested parties should be able to apply to the Court to provide relief if there are fears that the conditions of statutory management are oppressive or unfairly discriminatory.

Privilege

64. If adopted, would the Law Commission's proposals require a privilege to be created to protect statutory managers? If so, what limits should be placed on the privilege? Should it be necessary to prove malice, or is bad faith sufficient? Should a negligent statutory manager be protected from defamation actions?

We agree that the proposals would require some protection to be created for statutory managers from fear of defamation action. We believe that a limit should be placed on privilege and that there should be a 'bad faith' test. We do not believe that a negligent statutory manager should be protected from defamation action.

Single Statute

65. What, in your view, are the advantages of enacting a generic insolvency statute? Do you support the advantages outlined by the Commission?

We support the advantages outlined by the Commission.

66. To what extent will a single statute aid accessibility to the law? Will there be any corresponding effect on compliance costs?

Having a single statute should aid accessibility to the law and this should help reduce compliance costs.

67. What, in your view, are the disadvantages? Do you believe there are other disadvantages aside from those outlined by the Commission?

No other disadvantages spring easily to mind.

68. Can issues particular to personal insolvency be catered for in a generic insolvency statute?

Yes.

69. Do you consider that the advantages of enacting a single statute to deal with all insolvency regimes clearly outweigh the disadvantages?

Yes.

70. What are your views on the Commission's proposed outline for the statute? Do you agree with the scope of the proposed statute? For what reasons?

The proposed outline seems reasonable.

71. How far should a generic statute go in merging the law on personal and corporate insolvency?

We agree that the law should be synthesised as suggested by the Commission.