Submission

by

Business NZ

to

Ministry of Economic Development

on the

Business Rehabilitation Insolvency Review Discussion Document

7 August 2002

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BUSINESS REHABILITATION
INSOLVENCY LAW REVIEW
DISCUSSION DOCUMENT

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1. Introduction

1.1 This submission is made on behalf of Business New Zealand, incorporating regional employers' and manufacturers' organisations. The regional organisations consist of the Employers and Manufacturers Association (Northern), Employers and Manufacturers' Association (Central), Canterbury Manufacturers' Association, Canterbury Employers' Chambers of Commerce, and the Otago-Southland Employers' Association. Business New Zealand represents business and employer interests in all matters affecting those sectors.

1.2 Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and to regain a place in the top half of the OECD in per capita GDP terms. This is a goal that is shared by the Government. It is widely acknowledged that consistent, sustainable growth in real GDP per capita of well in excess of 4% per annum would be required to achieve this goal in the medium term. Continued growth of around 2% (our long-run average) would only continue New Zealand's relative decline.

1.3 Confidence in the integrity and quality of business regulation, and in its consistent and equitable application, is critical for fostering trust in the business environment, and increasing the levels of business competitiveness and economic growth. A strong insolvency system should be an important pillar of support for commerce and it is vital that the insolvency law system should have the trust and confidence of all participants.

1.4 Business failure is an inevitable and important element of a dynamic business environment, so a fair and efficient regime to facilitate the liquidations of failed businesses is necessary to enable resources (both monetary and non-monetary) to be invested in more profitable and economically efficient concerns. However, we submit that the law should also assist in rehabilitating those businesses that would have a viable future.

1.5 In New Zealand, concerns have been expressed that the practical application of insolvency law (i.e., Part XIV an Part XV of the Companies Act 1993) has resulted in liquidation being preferred over business rehabilitation. This discussion document reflects those concerns and essentially explores whether New Zealand should adopt the Australian approach, which seems to be more rehabilitation-friendly.

1.6 Business New Zealand supports harmonisation of trans-Tasman business law where the benefits of doing so outweigh the costs. Clearly there are benefits

to having similar laws in place when the two economies are being drawn closer together under CER and the TTMRA. Australia is New Zealand's largest market for manufactured exports, but what is probably less well known is that the reverse has also been true. The two countries' financial services industries are now also highly integrated. Harmonised legislation and regulation would obviously make it easier for exporters and service industries to operate in each other's countries and reduce compliance costs.

1.7 On the other hand, harmonisation has implications for New Zealand's sovereignty, particularly when, due to our small size and lack of political 'clout', the reality is that New Zealand has often simply adopted Australian legislation and regulation. New Zealand law can be superior to Australia's, providing a competitive advantage to businesses operating here, and this should not be conceded lightly. Some have argued that if two countries' business environments are identical then firms will usually choose to locate their operations in that with the largest domestic market (in this case Australia). They argue that New Zealand would be better served by actively competing with Australia to deliver a more attractive business environment.

1.8 Business New Zealand therefore submits that while it supports the principle of harmonising business law with Australia, the test should be whether the benefits of doing so clearly exceed the costs. This applies as much to insolvency law as to any other aspect of business law. There is, however, a view by others in the business community that New Zealand should more rapidly harmonise with Australia by seeking to adopt that country's business law *unless* there are aspects of it that would be clearly detrimental to New Zealand commercial interests.

1.9 The remainder of this submission attempts to answer some of the questions raised in the discussion document.

2. Answers to Questions Raised in Discussion Document

2.1 Overall, Business New Zealand considers the discussion document to provide a useful and succinct summary of the problems with the existing legislation and provides clear alternatives to move forward. In general, we support a number of aspects of the Australian regime, but not adoption in its entirety.

2.2 We consulted our member organisations on the discussion document and posed a number of questions. Opinion was divided on a number of issues, with some supporting adoption of the Australian regime in its entirety and others favouring a more incremental approach. The answers below attempt to find a balance between the two perspectives.

Q1 *Do you agree that the current New Zealand regime favours liquidation over rehabilitation? If so, is this a problem?*

The current New Zealand regime would appear to favour liquidation over rehabilitation essentially because there is no "stay" over all creditor action during the critical period when a rehabilitation programme could be developed.

In the current context, this is a problem as banks, creditors, directors and managers usually leave any rehabilitation decisions too late in the life of a company, which means that normally liquidation is the only alternative.

If a period of "stay" was available and all parties were encouraged to make proactive rehabilitation decisions, this would add significantly to the rehabilitation process in New Zealand. An amendment to the current legislation to this effect would be useful.

However, while we recognise that encouraging rehabilitation is desirable in many respects, liquidation may often be the best way to ensure that resources are made available for more efficient firms. That period of stay should be relatively brief to focus attention on quickly evaluating the rehabilitation option at a high level and so avoid unnecessary delay where liquidation is inevitable. The point we are making is that there needs to be a balance.

Q2 *Do you prefer Option 1 (amendments to strengthen the current law), Option 2 (a new rehabilitation regime) or the status quo?*

We believe that Option 1 with a period of "automatic stay" would give restructuring practitioners the necessary time and control over rehabilitation situations to make them effective. An important proviso would be the practitioners being given the rehabilitation cases to deal with earlier than they are currently.

Q3 *Do you agree that New Zealand should adopt the Australian approach?*

As a general principle, we do not believe that New Zealand should simply adopt the Australian approach in its entirety unless the benefits of doing so clearly outweigh the costs, and then only if we cannot design a better system ourselves. New Zealand should adopt best international practice where appropriate. If this means adopting aspects of the Australian approach and amending to suit New Zealand conditions, then this would be acceptable.

We understand that one reason the Australian rehabilitation regime is regarded as being successful by its proponents is that it makes directors personally liable for unpaid taxes – providing a very strong incentive for directors to come forward early, and so increasing the chances of a successful rehabilitation.

Business New Zealand would be strongly opposed to making directors personally liable for unpaid taxes, except for very tightly defined illegal actions. Doing otherwise would represent an unnecessary drawing aside of the 'corporate veil' and, as such, would serve to undermine the very reason for incorporation – that it removes personal liability, the absence of which acts as an encouragement for entrepreneurial activity.

Making directors personally liable would be a significant disincentive to people wishing to make themselves available for corporate governance roles. We also consider that the Inland Revenue Department has more than enough protection as a preferred secured creditor.

When the Employment Relations Bill was introduced in 2000, it was proposed that directors and officers of a body corporate would be made personally liable for unpaid wages or holiday pay under the Minimum Wage Act or the Holidays Act. Personal liability of directors was one of the critical concerns for the business sector with the Bill, and it was a significant factor in a sharp fall in business confidence in mid-2000[1]. As a result of submissions received from the business sector, the Select Committee removed this provision and the Bill was passed without making directors personally liable.

Q4 *Do you agree that the Australian safeguards for creditors are sufficient?*

Yes, the safeguard of a secured creditor enforcing their security within 10 days would be effective.

Under New Zealand law, creditors may take court action against a company/directors for proceeding with a "hive down" to the detriment of all other creditors. Much of the onus on this creditor process lies with the skill, experience and professionalism of the administrator. However, for ease of administration and to protect against unscrupulous administrators, we consider that the Australian approach could be adopted.

Q5 *Do you agree with the Australian approach to initiation by a business, creditor, or liquidator?*

Yes, we agree that action should be able to be initiated by a business, creditor, or liquidator. We do not consider though that there is anything particularly unique in this action, as it would appear to be similar to New Zealand under Part XIV of the Companies Act.

Q6 *Do you consider that the reduced costs associated with an "automatic stay" outweigh the benefits of court involvement in the process?*

Yes, definitely. A court process is not only time-consuming, but can be very expensive. An automatic stay is simple to implement and treats all creditors together. Provided that there are safeguards around "hive down" and the inability of debtors transferring assets away from creditors, we consider the "automatic stay" would be adequate and cost-effective to administer.

Q7 *Do you agree with the Australian approach to lengths of stay? If not, what length of stay would you prefer?*

If a rehabilitation action is to be successful, the administrator must act quickly. We understand that in New Zealand most practitioners have a "gut" feeling within a few working days. The balance of the time is usually information

[1] NZIER Quarterly Survey of Business Opinion:

Quarter	% Expect 'Deterioration'	% Expect 'Stay the Same'	% Expect 'Improvement'
March 1999	6%	53%	40%
March 2000	22%	52%	25%
June 2000	53%	36%	11%
September 2000	56%	32%	12%

sourcing and drafting the plans. Most situations would often be completed within 12 days, with a further period to finalise reports, consult creditors and call meetings. On balance, after consultation with our members, we have would prefer a 30-day stay, with no extensions (rather than the Australian limit of 21 days, which may be extended on application to 28 days).

Q8 *Do you agree with the Australian approach to the end of stay, or do you prefer automatic liquidators or failure?*

The Australian option to be able to "swap" procedures may be appropriate and it would appear to allow for flexibility and a greater chance of rehabilitation. It has been suggested to us though that any alternative plan would also have to carry a "stay" on creditors to be effective.

Immediate liquidation or failure is not generally conducive to trying to rehabilitate companies, but it may be the only option if the business is beyond saving and if resources can be more efficiently allocated elsewhere.

Q9 *Do you agree with the Australian approach of control of management by the administrator? If not, do you prefer the replacement of management by a team of professional managers?*

Yes, we consider control of management by an administrator is easy to administer and quick to implement.

The administrator should be a recognised restructuring professional but would not necessarily have to be an insolvency practitioner. There should also be other industry specialists who could be recognised rehabilitation experts. Whether 'recognition' requires the registration of such professionals is by no means clear to us. We discuss our concerns on registration further under question 12.

A professional administrator should always have available experts who can be called upon assist or advise in any rehabilitation plan and/or implementation and it should not be necessary therefore to legislate for a team of professional managers. A 'team of professional managers' would be more expensive and cumbersome than a single administrator with access to a team of advisors, or using existing management.

Q10 *Do you agree with the Australian approach to access finance?*

Yes, although we understand that in New Zealand there would be few financiers who would support a rehabilitation plan without appropriate security and cash flow under the plan. If these securities were not already available to the company pre-administration, then there is no circumstance in which a New Zealand lender would advance the money unsecured.

Further, we understand that an administrator would not borrow for a rehabilitation plan unless it was on the assets of the company or was carrying an indemnity of an appointer. Given the circumstances of a restructuring, it would be most unlikely to proceed in this way.

Q11 *Do you agree with the Australian Creditor Voting provisions?*

Although there are compelling arguments for having similar voting rules, particularly in the event of trans-Tasman administrations, it is not a clear-cut issue and it is essentially a matter of balancing the interests of debtors and creditors.

While some businesses we consulted prefer the simplicity of the Australian system, others we consulted considered the comfort level of 75% across all classes of creditors to be more appropriate. The rationale was that creditors may have been forced into a position of stay and that significant creditors should have a greater level of say. Therefore, we consider that it would be most appropriate for any rehabilitation plan to have a simple majority (50%) for acceptance in number but a large majority (75%) by value.

Q12 *Do you agree with the Australian approach to regulating administration?*

Not unless there are compelling reasons. Taking a wider business perspective, we would be most concerned if regulating the administration profession were to result in a 'closed-shop', a reduction in competition, and an increase in costs of administration. Regulation must be considered carefully using first principles – is having an unregulated administration profession causing problems, and if so is regulation the answer?

We believe that administration should not only be open to accountants and insolvency practitioners but should also provide for other industry specialists to have a role. Any 'regulatory fix' should recognise this issue.

Q13 *Do you think the benefits of co-ordinating with Australia in this area would outweigh the additional costs?*

Business New Zealand would prefer a relatively small number of focused amendments to the Companies Act 1993 rather than the wholesale adoption of the Australian approach on the basis that it would be easier, cheaper, and more efficient to modify rather than make significant changes.

Useful Australian-style amendments might include:

- Automatic stay of up to 30 days;
- Ability of secured lenders to act under security up to 10 days;
- Ability to swap procedures at the end of a stay;
- Control of management by an administrator; and
- Ability of an administrator to raise finance.

Greater education and encouragement of directors and companies seeking rehabilitation help at an earlier stage would also be useful.

Business New Zealand is strongly opposed though to any moves to make directors personally liable for unpaid taxes or any other secured debts.

Although Business New Zealand does not support adopting the Australian approach in its entirety, we do not see a problem with discussing issues of mutual interest with Australia, or any other country, either bilaterally or multilaterally in relevant international fora (e.g., UNCITRAL).