DRAFT ONLY

Submission

By

Business NZ

to the

Commerce Select Committee

on the

Insolvency Law Reform Bill

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INSOLVENCY LAW REFORM BILL
SUBMISSION BY BUSINESS NEW ZEALAND[1]

1.0 Introduction

1.1 Business New Zealand welcomes the opportunity to comment on the Insolvency Law Reform Bill *("the Bill").* Business New Zealand's submission is restricted to aspects associated with the issue of "priority debts".

1.2 Priority debts are outlined in company law. It is noted that changes were made in 2004 to, firstly, include redundancy payments as priority debts (previously they ranked alongside unsecured debtors). Secondly, the priority afforded to employees for arrears of salary, wages, and related earnings (including redundancy payments), accrued over the previous four months was increased from $6,000 to $15,000.

1.3 While Business New Zealand opposed the changes to include redundancy payments as a priority debt in its submission to the Commerce Select Committee on the Status of Redundancy Payments Bill (2003), we accept that the changes have been made and that the preferential claims included in the Insolvency Law Reform Bill will closely mirror the preferential claims in the amended Companies Act 1993.

1.4 Business New Zealand is aware that the government proposes to review the adequacy of redundancy law provision. While Business New Zealand accepts the rationale for a consistent approach to apply in respect to priority debts, Business New Zealand is most concerned to ensure that any new policies introduced by Government do not impact adversely on other (unsecured) creditors, or the cost of credit.

1.5 An example of the above adverse outcome would be if the Government were to legislate minima redundancy compensation if a person is made redundant (either as part of a company restructuring or as a result of a company collapse). This could have significant implications for unsecured creditors which would likely result in either the general cost of credit increasing (on the margin) or the amount of credit being restricted. In both cases this would impact adversely on companies and ultimately their employees.

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[1] Background information on Business New Zealand is attached as Appendix 1.

1.6 Business New Zealand also questions the appropriateness of the Government, in particular the Department of Inland Revenue (IRD) remaining as one of the priority creditors when a business is insolvent. By doing this, the Government is holding to itself the ability to claim priority ahead of many others with just as good if not better claims.

2.0 Recommendations

Business New Zealand **recommends** that:

the Government avoid the potentially adverse outcomes for companies, their employees (and other supplying companies and their employees), associated with prescribing minima for redundancy compensation in circumstances of company restructuring or collapse.

Business New Zealand **recommends** that:

the Government's status as a priority creditor be removed.

3.0 Section 1: Discussion on Nature of Priority Debts

3.1 Often many people and organisations lose monies owed when companies collapse and generally consider that they are "more deserving" of payment than someone else is.

3.2 The simple fact is that priority granted to one particular group will obviously be at the expense of other creditors who will have even less chance of recovering payments. If other groups or individuals are given preferential treatment in respect to claims in the case of insolvency, then the risk is automatically increased for remaining creditors. In other words, remaining creditors are less likely to get any money owed to them. As a result they are likely to change their behaviour to compensate for the increased risk involved. This may involve a number of reactions from banks and clients who supply finance, goods and services to particular businesses.

Reaction of financers

3.3 In general terms, banks and other lending agencies require security over their investments. While many factors impact on the cost of credit, including the competitiveness of the financial sector, in general the greater the security over a loan that a company can offer, the lower the interest rate. Vice versa, the lower the level of security, the higher the interest rate to compensate for the risk of non-payment. In some cases the risk may be too high for banks to cost-effectively manage; hence they may deny credit completely.

3.4 As a final precaution against risk of non-payment, lending agencies may shorten the time frames in which lending is made. In other words, ensure that all loans are short-term. This could potentially impact on the ability of the company to expand, should credit lines be uncertain over the medium to long-term.

3.5 If banks or other lending agencies perceive that the risk of not being paid for debts owed has increased, there will be a tendency (on the margin at least), to call in loans earlier, thus potentially reducing the ability of companies to trade through difficult periods. In other words, lending agencies may simply conclude that the risk of allowing a business to continue to trade is too great if that company has a large number of preferential claims (whether in respect to payments to employees or other claims such as taxation).

Reaction of suppliers of goods and services

3.6 Unsecured creditors may take greater precautions to protect ownership of any goods or services provided to a company if they perceive that their chances of being paid are diminished as a result of other creditors receiving higher priority in the payment of debt. This will entail greater use of complex contracts to try and protect their assets. Additionally, it will result in greater monitoring by suppliers of the financial position of companies they are supplying goods to. It could also encourage companies supplying goods to take out insurance against non-payment or utilise other such risk minimisation strategies. Irrespective of which approach is taken to manage this risk, monitoring and transaction costs will increase, thus raising the price of services and goods supplied to that company. Alternatively, some companies may simply refuse to provide inputs to a company if they feel the risk of non-payment is too great.

Impact on employees

3.7 While efforts to give higher priority to employee salaries and wages and redundancy payments are understandable, the likelihood is that increasing the status of redundancy compensation (and raising the threshold) to $15,000 (in line with the Companies Act) will impact adversely on the precise employees this Bill is intended to help.

3.8 Rather than being neutral in respect to negotiating redundancy agreements, there may be a tendency for companies, particularly those with a large labour component as inputs into the production process, to take measures to reduce the risk of being open to redundancy compensation. Some companies may be encouraged by such regulations to state within employment agreements that in the event of redundancy, no or a much lower level of compensation will be payable.

3.9 There will be potential (on the margin at least), for greater incentives on companies, when considering expansion decisions, to minimise the demand for labour and focus on expanding capital investment. In other words, giving priority to salary and wages and redundancy payments, could encourage a bias towards greater investment in capital vis-à-vis labour.

3.10 Business New Zealand notes that the Bill puts in place some "safeguards" to arguably minimise the above adverse impacts (e.g. capping payments for salary/wages (and/or redundancy) at $15,000 and ensuring that the $15,000 is only adjusted every 3 years in line with movements in average weekly earnings (total, private sector), calculated with reference to the Quarterly Employment Survey (QES)).[2] Notwithstanding the above, Business New Zealand would be very concerned should the government move to require that all companies be required to pay redundancy compensation in case of redundancy (either as a result of company restructuring or company collapse). For companies with relatively high labour cost content the impact on both the cost and availability of credit could be material. Similarly, the ability to source goods and services (on the margin) could be made more difficult and costly as businesses build in risk margins in their dealings with businesses with large contingent liabilities.

[2] See clause 274 "Provisions concerning preferential payments to employees"

Impact of compulsory redundancy payment provisions within employment contracts/agreements

3.11 According to Statistics New Zealand's NZ Business Demographic Statistics the number of non-farming enterprises was around 334,000, employing around 1.73 million employees.

3.12 Excluding farming, most enterprises in New Zealand (96%) had fewer than 20 employees as at February 2005. However, these enterprises only accounted for 30% of all employees. Conversely enterprises with 100 or more employees made up 0.5% (927) of the total number of enterprises in New Zealand but employed 47% percent of the total number of employees.

3.13 It is difficult to determine what the precise impact would be of requiring employers to pay redundancy compensation to all staff as a legislative requirement as this would be dependent to some extent on the nature of those obligations (e.g. minimum legislated amount required etc).

3.14 However, given that around 9% of employees are covered by collective employment contracts in the private sector (and assuming that most if not all collective agreements have a redundancy provision inserted in them), then the impact of requiring all agreements/contracts to have redundancy clause provisions could be significant.

3.15 However, it should be noted that as outlined above, the top 1000 companies employ around 50% of the total number of employees engaged in New Zealand. Generally (although not always), these larger companies include redundancy payment provisions within their contracts/agreements with their employees.

3.16 Research (Victoria University Bargaining Trends and Employment Law Update) suggests that in excess of 80% of employees in New Zealand are likely to be already covered by some sort of redundancy payment provisions within their employment contracts/agreements.

3.17 Given this sort of coverage, the assumption could naively be made that a simple extension to require all employers to provide a minimum level of redundancy payments would have little impact. This would be an entirely false assumption to make for a number of reasons.

3.18 Firstly, companies at greatest risk of collapse are generally not larger companies which are often subject to market disciplines and the threat of takeover through non-performance. The risks of collapse are much more prevalent in smaller companies which are often unlisted and not subject to day-to-day rigorous monitoring by market analysts and others.

3.19 Secondly, smaller companies, in general, tend not to have the degree of systems and monitoring in place which apply to larger companies. This can allow flexibility for growth but also can lead to added exposure to the risk of failure (company collapse).

3.20 Thirdly, smaller companies often rely on significant goodwill on the part of suppliers and financers which could result in serious problems for both financers and suppliers if a small company becomes insolvent with little chance of such creditors obtaining what is owed to them – with flow on effects to those firms' employees.

3.21 All of the above suggests that the government should be very mindful of introducing any amendments to labour laws which could further increase the risk of non-secured creditors not receiving what they are owed in favour of employees' wages/salaries (and more particularly, redundancy compensation payments).

Priority status given to Government

3.22 Business New Zealand also questions the appropriateness of the Government, in particular the Department of Inland Revenue (IRD) remaining as one of the priority creditors when a business is insolvent. By doing this, the Government is holding to itself the ability to claim priority ahead of many others with just as good if not better claims.

3.23 The Government has previously stated that these government agencies are given priority on the need to maintain the revenue base for the Government to further other objectives. However, Business New Zealand submits that it would be more beneficial to the economy if unsecured creditors were given higher priority over the Government, which could prevent further business closures and an increase in business costs. The risk (potential revenue loss) to Government of insolvency could generally be considered much less than to many other businesses and individuals likely to be much more adversely affected as a result of being an unsecured creditor. Government can spread the risk of revenue loss against the population as a whole whereas individuals and companies can face a disproportionate share of the risks associated with a company collapse. Therefore, Business New Zealand submits that the government (and its agencies) not remain a priority creditor.

3.24 Many businesses supplying goods and services are likely to be unsecured creditors who in turn have employees whose employment could be jeopardised as a result of a company collapse. In this context the flow-on effects of granting priority status need to be considered.

4.0 Conclusion

4.1 Business New Zealand understands the objective of this Bill (which is largely to bring insolvency law into line with the Companies Act), and that government is aware of the trade-offs involved in providing greater priority for wages/salaries and redundancy payments by explicitly implementing some safeguards (e.g. capping amounts to $15,000 and ensuring that the cap can only be raised by moments in the QES).

4.2 Notwithstanding the above, the Government needs to be very mindful of any further changes to labour relations legislation or other legislation which could further impact on the cost and availability of capital, or potentially impact on the provision of inputs to a company. In this respect, Business New Zealand would view negatively any move by government to mandate for minimum redundancy compensation to be paid in cases of business restructuring and/or company collapse. As stated earlier in this submission, the result would be that other creditors, including financers would be in a less secure position which would typically result in three adverse outcomes. Firstly, the cost of credit would likely increase (on the margin) to compensate for such risk. Secondly, the availability of credit would likely diminish. Thirdly, the ability of “at risk” companies to access needed goods and services could be jeopardised. Finally, the domino effect on employees of other unsecured creditors could be significant.

Business New Zealand **recommends** that:

the Government avoid the potentially adverse outcomes for companies, their employees (and other supplying companies and their employees), associated with prescribing minima for redundancy compensation in circumstances of company restructuring or collapse.

Business New Zealand **recommends** that:

the Government's status as a priority creditor be removed.

APPENDIX 1

BACKGROUND INFORMATION ON BUSINESS NEW ZEALAND

Encompassing four regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 57 member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). An increase in GDP of at least 4% per capita per year is required to achieve this goal in the medium term.

The health of the economy also determines the ability of a nation to deliver on the social and environmental outcomes desired by all. First class social services and a clean and healthy environment are possible only in prosperous, first world economies.