

# **Insolvency Law Review: Tier Two Consultation Points**

Competition and Enterprise Branch

May 2001

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# Disclaimer

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## 1. Purpose

This document is a questionnaire, designed for the purpose of consultation on the draft Law Commission report, "Insolvency Law Reform: Promoting Trust and Confidence", an advisory report to the Ministry of Economic Development. The report covers all the issues in Tier Two of the Government's insolvency law review. For any enquiries regarding these documents or the review, please contact the Ministry (details provided below).

There are two documents that provide background reading on Tier Two issues. These are:

- Corporate Rescue - a report prepared for the Ministry of Economic Development by David Brown, Deputy Dean of Law, Victoria University of Wellington <http://www.med.govt.nz/ri/insolvency/tiertwo/rescue/index.html>
- A Cost-Benefit Analysis of the Commission's Tier Two Proposals - a report prepared by Professor Neil Quigley of Victoria University of Wellington (to be made available late May 2001).

## 2. Submissions

The Ministry welcomes comments, questions and submissions on any of the issues covered in the Law Commission's report and the Ministry's questionnaire.

The Law Commission has prepared the advisory report and the Ministry of Economic Development the accompanying questionnaire. They do not represent Government policy. Written submissions on the issues raised by the advisory report are invited from interested parties. The **closing date for submissions is 29 June 2001**. The Ministry will then further analyse the issues before preparing its final advice to Ministers later in 2001.

Submissions should be made out to:

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Competition and Enterprise Branch  
Ministry of Economic Development  
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The contents of submissions provided to the Ministry in response to these discussion documents will be subject to the Official Information Act 1982 and the Privacy Act 1993. If the Ministry receives a request for information contained in a submission, we would be required to consider release of the submission, in whole or in part, in terms of the criteria set out in these Acts.

In providing your submission, please advise us if you have any objections to the release of any information contained in your submission and, if you do object, specify which parts of your submission you would wish to withhold and the grounds for withholding.

### **3. Objectives**

The objectives set by the Government for the review are to:

- a. provide a predictable and simple regime for financial failure that can be administered quickly and efficiently, imposes the minimum necessary compliance and regulatory costs on its users, and does not stifle innovation, responsible risk taking and entrepreneurialism by excessively penalising business failure;
- b. distribute the proceeds to creditors in accordance with their relative pre-insolvency entitlements, unless it can be shown that the public interest in providing greater protection to one or more creditors (statutory preferences) outweighs the economic and social costs of any such preference;
- c. maximise the returns to creditors by providing flexible and effective methods of insolvency administration and enforcement which encourage early intervention when financial distress becomes apparent;
- d. enable individuals in bankruptcy again to participate fully in the economic life of the community by discharging them from their remaining debts in appropriate circumstances; and
- e. promote international co-operation in relation to cross-border insolvency.

These objectives are diverse, and there are tensions between some of them. The Ministry seeks information from stakeholders on both the Commission's specific recommendations and the wider issues that are relevant, given the Government's objectives in reviewing insolvency law.

When responding to the following questions the Ministry requests that you provide explanations with your answers. To provide some guidance on the information

sought, explanations that relate to costs and benefits, evidence or examples, and alternative perspectives on the issues raised would aid policy development on these issues.

## **4. Role of the State: Consultation Points**

### **4.1 Summary of the Paper on the Role of the State**

In Part 2 of the report, the Law Commission considers the role of the state in insolvency.

The Commission has identified roles of the State as a legislator, enforcer, regulator, office holder, and educator. When considering these roles, the Commission focused on the integrity of the overall system, including the need for cases to proceed with due dispatch, the need for due compliance with legal processes; the need for all professionals involved to comply with standards; clarity; transparency and fairness; and, predictability and accountability.

The Commission has identified problems (paragraph 121 - 127) within the following roles:

- Enforcer (the State as an enforcer of insolvency regulation);
- Regulator (the State as regulator of the insolvency regime and its participants);
- Office Holder (the State as an insolvency practitioner, i.e. as administrator of bankruptcies).

It is important to note the connections between the roles of regulator and office-holder in the Commission's commentary and recommendations.

### **4.2 State Role in Enforcement**

The Commission has identified a series of issues concerning the State's current enforcement framework (paragraphs 123 and-126). The Commission also raises the issue of what level of involvement in enforcement should be undertaken by the State. The following organisations, for example, have a role to play in State enforcement: the Serious Fraud Office, the Securities Commission, the Commerce Commission, the Registrar of Companies, and the Official Assignee.

1. Is the State performing its performance function adequately? If not, what enforcement tasks are not being performed adequately?
2. What have been the consequences of any inadequate enforcement?
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?
4. What are your views on the three options for state enforcement identified in paragraph 157 of the Law Commission's report?

5. Are there any better options?

The Law Commission has prospectively discussed whether there will be a need for greater insolvency law specialisation within the Court system (paragraphs 164-169).

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

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

### **4.3 State as Regulator**

The Law Commission has identified several problems with the current regulatory regime. These include: a concern regarding the adequacy of quality controls over the administration of insolvency; the difference between the standards for private practitioners and those for the Official Assignee, when carrying out duties as a liquidator; and the inability of small debtors and creditors to identify qualified and impartial practitioners.

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

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?

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

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

### **4.4 State as Office Holder**

The Commission expresses concern over the lack of regulatory safeguards for the appointment of suitably qualified practitioners, and the monopoly the State has in bankruptcies, under the Insolvency Act 1967 (paragraph 186).

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?

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 insolvency regime but leave the administration of other liquidations and bankruptcies, to the private sector? Are there any better options?

### **4.5 A New Regulatory Authority**

The Commission has identified problems within the following roles:

- Enforcer
- Regulator
- Office Holder

The Commission proposes the creation of a new business unit to address enforcement, regulation and office holding issues (paragraph 193). The new organisation would work with the two existing business units that comprise the current enforcement authority, the Companies Office and the New Zealand Insolvency and Trustee Service (“NZITS”).

The Law Commission has identified certain potential tasks that the Inspector-General could undertake to meet the needs of the commercial community. These include:

- All public enforcement functions currently undertaken by the Official Assignee (“OA”) and the Registrar of Companies, as well as investigative functions currently undertaken by the Registrar of Companies, including all investigations and prosecutions (including civil disqualification proceedings);
- Other public functions including reports to the High Court for discharge from bankruptcy, as are currently undertaken by NZITS / OA;
- Oversight of other office holders, including the Official Assignee;
- Determining whether the office holder is complying with the obligations conferred by statute and take appropriate action to seek disqualification of the person if necessary;
- Set standards for performance by office holders, issues as enforceable directives;
- Public education functions;
- Sanctioning of remuneration payable to a liquidator appointed by a court in excess of regulatory limits; and
- Collection of statistical information nation-wide, currently undertaken by NZITS.

The following questions are based on paragraphs 192 – 203 of the report, regarding the Commission’s provisional recommendation of a new regulatory authority.

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

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

16. What are your views on the addition of a new business unit to deal with the tasks listed above?

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

## **4.6 State as Educator**

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

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?

# **5. Consultation Points: Business Rehabilitation**

## **5.1 Summary of the Paper on Business Rehabilitation**

In Part 3 of the report, the Commission considers whether New Zealand should introduce a business rehabilitation regime into its insolvency laws.

The Commission summarises relevant economic and legal considerations in making that decision and comes to the conclusion that New Zealand's insolvency laws could be improved by introducing a targeted business rehabilitation regime.

The Commission outlines the benefits to be gained from business rehabilitation and recommends the removal of tax disincentives for debtors entering into compromises with creditors. The report also notes INSOL International's guidelines for conducting informal workouts.

The Commission outlines a proposed rehabilitation regime, together with other suggested amendments to the present law. The Commission recommends that the regime be focussed on the activity of the business rather than the form of the entity, and have strict entry criteria. The Commission details the specific features of the proposed regime and then sets out the advantages of the regime.

## **5.2 Problem Definition**

In considering whether there is any need to introduce a general rehabilitation regime into New Zealand containing stays against secured and unsecured creditors, the Commission has found no evidence of any problem that needs to be remedied (paragraphs 227 and 233). However the Commission also reaches the view that New Zealand's insolvency laws could be improved by the introduction of a targeted regime (paragraphs 234-8).

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

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?

22. Do you believe 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?

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?

### **5.3 Informal Workouts**

The Commission sets out guidelines for conducting informal workouts whereby debtors and creditors can reach a compromise without using the regulatory regime and recommends consideration be given to removing the tax liability for written-off debt of debtors that enter into collective compromises (paragraph 239).

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

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?

### **5.4 Current Regulation**

In outlining a proposed rehabilitation regime, the Commission also suggests amendments to the present law, in particular:

- that Part XIV Companies Act 1993 does not require significant alteration, but recommends its provisions be synthesised with Part XV of the Insolvency Act 1967; and
- that Part XV of the Companies Act 1993 be repealed.

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

### **5.5 Law Commission's Proposed Regime**

The Commission proposes that a new rehabilitation regime be introduced, but with strict entry criteria. The main features suggested are:

- Entry into the regime would require a court order. The proponent would need to satisfy the court that the business' records will enable a prompt assessment of its future viability to be made, that there is a real prospect that creditors will accept the proposal, and that once the proposal is implemented, the business will be able to satisfy the solvency test;

- Once an order is made, a 14-day stay on all creditors' claims (secured and unsecured) will come into effect. There is provision for a further 14 day extension; and
- An impartial administrator would also be appointed to carry out an investigation, negotiate with creditors, protect the assets of the business, and oversee the existing management.

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

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?

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

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

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

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?

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?

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

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

## **5.6 Corporate vs. Business Rehabilitation**

The Commission recommends the rehabilitation regime should focus on saving the activity of the business rather than the form of the entity. A general rehabilitation scheme, then, would apply to individuals and companies.

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

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

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 was adopted? Are there any other risks?

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

## **6. Consultation Points: Statutory Management**

### **6.1 Summary of the Paper on Statutory Management**

In Part 4 of the report, the Commission considers the need to reform statutory management under the Corporations (Investigation and Management) Act 1989 ("CIMA").

The Commission identifies three potential benefits of statutory management as an insolvency procedure:

- it provides an extraordinary procedure for business rehabilitation;
- it enables insolvencies involving groups of companies to be dealt with as a whole; and
- it provides an emergency measure for ensuring the continuing supply of essential services if the providing companies are faced with collapse.

The conclusion reached is that most of the benefits will also be available from the Commission's proposed new rehabilitation regime. The Commission notes that statutory management may still be useful where:

- issues involving the public interest are involved; and
- a process is needed to bring order to chaos and then determine how to deal with the core business.

The Commission's key recommendations are:

- that statutory management should be preserved as a remedy of last resort to be used if:
  - i. the affairs of a corporation cannot adequately be dealt with by any other formal and collective insolvency regime; or
  - ii. the public interest requires it to be used.

- To suggest that the maximum initial period of statutory management should be three months, but with power to extend for a further three months;
- To suggest that decisions to invoke statutory management should be made by the High Court, with provisions for notice of the hearing to be given, and reasons to be given;
- To suggest that a report be provided to creditors and shareholders within one month, with a meeting to be held in the second month to decide what action should be taken.

## 6.2 Problem Definition

Section 4 of the CIMA states that the Act only applies where certain specified interests “cannot be adequately protected under the Companies Act 1955 [or the Companies Act 1993] or in any other lawful way.”

41. If there were no 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 the existing company and insolvency laws?

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

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

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 a more limited application?

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

## 6.3 Application of Statutory Management

The Law Commission recommends that statutory management be preserved as a measure of last resort to be used if:

- The affairs of the corporation cannot adequately be dealt with by any other formal and collective insolvency regime; or
- The public interest requires it to be used.

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

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

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

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

In Chapter 19 the Commission has recommended that there should be a targeted rehabilitation regime with a limited moratorium effective against all creditors.

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?

## **6.4 Commencement**

The Commission recommends that statutory management be commenced by order of the Court on the application of the Registrar of Companies. This removes the involvement of the Securities Commission, the Minister and the Governor General in Council from the commencement process.

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

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?

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?

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

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

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

## **6.5 Role of the Statutory Manager**

The Law Commission recommends that the statutory manager's role should be limited to determining whether the company should be returned in a solvent state to the directors, and if not, which insolvency regime would be most appropriate for the particular corporation.

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

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

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 of 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?

## **6.6 Costs**

The Law Commission has recommended that costs would be agreed between the statutory manager and the advisory committee with the sanction of the High Court.

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

## **6.7 Duration and Termination of Statutory Management**

The Law Commission recommends that the period of statutory management should be limited to 3 months with provision for the statutory manager to apply for an extension of the statutory management for a further period of up to three months. Application could also be made to the Court for an order terminating 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?

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?

## **6.8 Privilege**

The Law Commission has recommended that statutory managers be required to report more widely, to the Courts, the creditors and to the Advisory Committee. As a result they have recommended that a privilege be created in respect of reports by statutory managers so that they need not fear action for defamation unless malice is proved.

64. If adopted, would the Law Commission's proposals require such a privilege? If so, what limits should be 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?

# **7. Consultation Points: A Single Statute?**

## **7.1 Summary of the Paper on a Single Statute**

In part 5 of the report, the Commission lists the advantages and disadvantages of enacting a single statute to deal with all insolvency regimes.

The Commission concludes that the advantages clearly outweigh the disadvantages, and recommends the enactment of a generic statute. An outline for the statute is suggested.

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

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

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

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

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?

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