

## **New Zealand - Insolvency Law Review**

The Government's review of insolvency law has entered its second and final stage. The Ministry of Economic Development is currently consulting on a Law Commission advisory report, "Insolvency Law Reform - Promoting Trust and Confidence."<sup>1</sup> The report covers all the issues in Tier Two of the Government's insolvency law review and presents the Commission's findings and preliminary recommendations of these issues.

Consultation on Tier Two issues has already begun, with submissions due by Friday 29 June 2001.

### **Consultation with ICANZ**

The Joint Insolvency Committee (JIC) of the New Zealand Law Society and Institute of Chartered Accountants, has made regular and comprehensive submissions to the Ministry on all the issues in the review, to date. The JIC is a key stakeholder for the review, representing an influential pool of knowledge and expertise in insolvency, as evidenced by the many effective proposals submitted during various rounds of consultation. The contribution made by ICANZ to the insolvency law review, through the JIC, has been of significance and is greatly valued by the Ministry.

### **Background**

In May 1999, the Government agreed to a review of both personal and corporate insolvency law to be undertaken by the Ministry of Commerce (now the Ministry of Economic Development).

The law in personal insolvency (bankruptcy) in New Zealand was last reviewed in the 1960s resulting in the enactment of the Insolvency Act 1967. While the law of corporate insolvency has been more recently amended with the enactment of the Companies Act 1993, and related legislation, consideration of major policy issues and options for reform was deferred in 1993 in anticipation of a comprehensive and co-ordinated review of both personal and corporate insolvency.

It is considered that the existing insolvency law framework is not fundamentally flawed. Therefore, rather than a comprehensive first principles rethink of insolvency law, the review targets particular problem areas within the insolvency law regime.

The objectives set by the Government for the review are diverse and there are tensions between some of them. Objectives include providing a predictable and simple regime that will balance creditors and debtors rights and obligations. Another objective is to maximise returns to creditors by providing flexible and effective methods of insolvency administration and enforcement that encourage early intervention when financial distress becomes apparent.

Prevalent throughout the review is the fundamental objective to simplify and modernise the law relating to insolvency, while encouraging responsible risk taking but not stifling entrepreneurialism.

### **The review**

The insolvency law review is being progressed in two tiers.

Tier One issues were addressed first either because they were thought to be causing unnecessary costs and problems for business, or because they had been the subject of recent consideration by the Law Commission. Tier Two topics are generally deemed to be more complex and fundamental insolvency issues.

### **Tier One**

Bankruptcy administration is the procedure for administering the estate of an insolvent individual in order to distribute the debtor's assets to creditors, and discharge the bankrupt from any outstanding debt after the completion of this procedure. Policy analysis has been focused on the adequacy of the current bankruptcy administration procedure, given concerns that the legislation has become outdated. Recommendations take into account the considerable changes to the economic environment since the law was last reviewed. In particular, there are now more consumer debtors than business-related debtors. Consultation has endorsed key policy recommendations aimed at modernisation of the procedure; early intervention to maximise returns to creditors; reducing the need for Court involvement where appropriate; and clarification and simplification of petitions for bankruptcy.

Voidable transactions law provisions enable some transactions that occurred prior to formal insolvency to be set aside. Two key concerns with the existing law emerged during consultation. First, concerns have been raised about the lack of certainty surrounding certain key tests and in particular, the "ordinary course of business" exception. Second, there have been concerns about the lack of consistency between the rules, both substantive and procedural, on which the different types of transactions can be challenged. Consistency and certainty will be key themes in finalising options for reform.

Priority Debts provisions elevate particular creditors from the status of unsecured creditors to a position where they rank above secured creditors with floating charges and other unsecured creditors. In accordance with the objectives of the review, recommendations are based on maximising returns to creditors. The majority of submissions support limiting the Crown's position as a dominant creditor, by reducing the number of statutory preferences held by the government. To ensure consistency, the Ministry recommends harmonising the legislation relating to bankruptcy, receivership and liquidation.

The term Phoenix companies is used to describe businesses sold as a going concern to another company or to its managers soon after (or in some cases prior to) its failure. Abuse of the phoenix company mechanism occurs where a business is transferred at less than market value, reducing the funds available to creditors. There is a consensus of opinion that reform of law relating to abuse of phoenix companies is an enforcement issue. Submissions have generally endorsed recommendations to enhance effective enforcement.

Cross-border insolvency arises when an insolvent debtor is placed in a form of insolvency administration in one country but has assets or debts in other countries. The policy development is largely complete on cross-border insolvency, with general agreement among interested parties that New Zealand should adopt the UNCITRAL (United Nations Commission on International Trade Law) model law on cross-border insolvency<sup>2</sup>. The Model Law is designed to provide states with a modern, harmonised and fair framework to address more effectively instances of cross-border insolvency. The nature of the Model Law is uncontroversial because it does not alter the substantive insolvency law of any country that enacts it.

Following public consultation earlier this year, the Ministry is currently preparing final policy recommendations to the Government on the Tier One issues.

## **Tier Two**

Tier Two issues generally deal with broader and more fundamental issues regarding the structure and objectives of insolvency law.

The Tier Two issues are:

- The legal framework, whether personal and corporate insolvency law should be harmonised into a single statute;
- Statutory management;
- The role of the state and enforcement mechanisms in insolvency proceedings; and
- Rehabilitation and corporate rescue/voluntary administration procedures.

As noted above, the Law Commission has released a report on these issues. The report can be accessed on the Law

Commission's website at [www.lawcom.govt.nz](http://www.lawcom.govt.nz). For consultation purposes, the Ministry has released a questionnaire addressing the key issues raised by the Commission. The questionnaire is available on the Ministry's website, at [www.med.govt.nz](http://www.med.govt.nz).

Also available on the Ministry's website are two documents providing background to the Tier Two issues. Those documents are; a research paper on corporate rescue by David Brown, Deputy Dean of Law, Victoria University of Wellington; and an economic analysis of the Commission's Tier Two proposals by Professor Neil Quigley of Victoria University of Wellington.

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

The Government expects to introduce reforming insolvency legislation next year.

**BY EMMA COCKRELL**

**(Footnotes)**

<sup>1</sup> An edited version of this Advisory Report will be published as a Study Paper by the Law Commission in early June 2001, but can be currently accessed on both the Law Commission's website, at [www.lawcom.govt.nz](http://www.lawcom.govt.nz), and the Ministry's website, at [www.med.govt.nz](http://www.med.govt.nz).

<sup>2</sup> "Report 52: Cross-border insolvency Should New Zealand adopt the UNCITRAL Model Law on Cross-border Insolvency?"