



COVERSHEET

Minister	Hon Kris Faafoi	Portfolio	Commerce and Consumer Affairs
Title of Cabinet paper	Insolvency Law Reform	Date to be published	4 November 2019

List of documents that have been proactively released

Date	Title	Author
23 September 2019	<i>Insolvency Law Reform</i>	<i>Office of the Minister of Commerce and Consumer Affairs</i>
23 September 2019	<i>Insolvency Law Reform: Annex One - Minor Changes</i>	<i>Office of the Minister of Commerce and Consumer Affairs</i>
23 September 2019	<i>CAB-19-MIN-0491</i>	<i>Cabinet Office</i>
23 September 2019	<i>Regulatory Impact Statement: Insolvency Law Reform – Gift Cards & Vouchers</i>	<i>Ministry of Business, Innovation and Employment</i>
23 September 2019	<i>Regulatory Impact Statement: Insolvency Law Reform – Reckless Trading Claims</i>	<i>Ministry of Business, Innovation and Employment</i>
23 September 2019	<i>Regulatory Impact Statement: Insolvency Law Reform - Voidable Transactions</i>	<i>Ministry of Business, Innovation and Employment</i>

Information redacted

YES

Any information redacted in this document is redacted in accordance with MBIE's policy on Proactive Release and is labelled with the reason for redaction. This may include information that would be redacted if this information was requested under Official Information Act 1982. Where this is the case, the reasons for withholding information are listed below. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Some information has been withheld to maintain the constitutional conventions for the time being which protect the confidentiality of advice tendered by Ministers of the Crown and officials.

In Confidence

Office of the Minister of Commerce and Consumer Affairs

Chair, Cabinet Economic Development Committee

INSOLVENCY LAW REFORM

Proposal

1. This paper seeks agreement to improve aspects of insolvency law, notably in relation to voidable transactions and other recoveries, and preferential claims.

Executive Summary

Background

2. When a business is insolvent, there is, by definition, not enough money to pay every creditor what they are owed. A range of parties will have competing interests including creditors (some of whom will be secured, or have preferential claims), employees, insolvency practitioners and the debtor company's shareholders. Insolvency law seeks to strike a balance between these competing interests while being as consistent as possible with the principle that creditors with the same types of claim should be treated equally and without preference. This is referred to as the *pari passu* principle and it underpins insolvency law. Consequently, changes to insolvency law can be contentious, because they create winners and losers.
3. Corporate insolvency law also has impacts on whether insolvent companies will be rehabilitated or liquidated. The law should promote business rescue if some or all of the business of the company is viable. If not, the company should be liquidated in a reasonable and efficient manner.
4. I am seeking approval for a package of reforms which will improve the fairness, predictability and efficiency of insolvency law. The bulk of these reforms are drawn from recommendations made by the Insolvency Working Group (IWG). The IWG was established by the Government in 2015 to provide advice on aspects of corporate insolvency law. The IWG made 31 recommendations on a range of topics in its second and final report (Report No. 2).

Voidable transactions and other recoveries

5. The *Companies Act 1993* empowers liquidators to reverse certain types of transactions involving the debtor company that took place prior to the commencement of the liquidation. These include transactions that can be viewed as tantamount to fraud on the creditors of the debtor company, such as the sale of the company's assets at less than their market value.
6. Liquidators also have 'clawback' powers in relation to transactions that are not fraudulent but are inconsistent with the principle that creditors should be treated

equally. The 'voidable transactions' regime is based on the idea that companies are typically insolvent for months, sometimes years, before a liquidator is appointed. Individual creditors who have been paid in full during this time have received more than they would have obtained if the company had been liquidated before that payment was made. This is inconsistent with the equal treatment principle. For this reason they can be required to return the amount or difference, even though they may have received the payment in good faith.

7. At present, the clawback periods for these transactions are either two or three years. There are two sets of problems with these time limits. First, there is no reason for having different time limits for different types of transactions that are akin to fraud, or that favour parties who are related to the debtor company (e.g. a relative of a director of the debtor company). Second, the two year period for transactions with unrelated parties leads to excessive commercial uncertainty.
8. Consistent with the IWG's recommendations, I am proposing:
 - 8.1. to standardise recovery periods at four years in relation to transactions with related parties that are akin to fraud on creditors;
 - 8.2. to increase the voidable transactions period from two to four years where a creditor is a related party of the company; and
 - 8.3. to reduce the voidable transactions period from two years to six months where the creditor was an unrelated party.

Other significant issues

9. I am also recommending a number of other changes, including:
 - 9.1. expanding an existing employee payment preference to include long service leave and payments in lieu of notice;
 - 9.2. introducing a requirement for companies that issue gift cards or vouchers, and enter liquidation or receivership but continue to trade, to honour at least 50 percent of their value; and
 - 9.3. removing a barrier to liquidators taking claims against directors for reckless trading.
10. I am also recommending that the Ministry of Business Innovation and Employment (MBIE), the Inland Revenue Department and the New Zealand Customs Service be invited to undertake policy development on the possibility of improving the availability of tax debt information (such as a tailored information disclosure regime). This would be aimed at better supporting unsecured creditors, with a view to outlining potential policy options in a discussion document for public release in late 2020. This work will seek to better support unsecured creditors in making more informed commercial decisions.

Background

The Insolvency Working Group

11. In late 2015, the Government established the IWG to consider various issues relating to corporate insolvency law [EGI-15-MIN-0096]. The IWG comprised an independent chair, two insolvency practitioners, two insolvency law specialists, a credit industry specialist and a representative of the Official Assignee. The IWG produced two reports, both of which were released for public consultation.
12. Report No. 1, published in July 2016, covered the regulation of insolvency practitioners and voluntary liquidations. All but one of the recommendations in Report No. 1 has been given effect to through the *Insolvency Practitioners Regulation Act 2019* and *Insolvency Practitioners Regulation (Amendments) Act 2019*. I am advancing the other recommendation, to establish a director identification number, through a separate policy process because it has wider implications beyond insolvency law.
13. Report No. 2, which was published in May 2017, covered:
 - 13.1. voidable transactions, voidable charges and other recoveries;
 - 13.2. incentivising liquidators to pursue reckless trading claims;
 - 13.3. preferential claim issues relating to employee entitlements, gift cards and vouchers, and Inland Revenue and Customs preferences
 - 13.4. other potential improvements to insolvency law; and
 - 13.5. the recovery of losses by Ponzi scheme investors.
14. In order to maintain consistency between corporate and personal insolvency law, many of the corporate insolvency law changes should also be made to personal insolvency law, which is regulated under the *Insolvency Act 2006*.

Issue A: Voidable transactions, voidable charges and other recoveries

Voidable transactions

15. Companies are typically insolvent for months, sometimes years, before a liquidator is appointed. Thus, the Companies Act provides for the equal treatment principle to be applied prior to the commencement of liquidations by allowing the liquidator to set certain transactions aside (e.g. where an ordinary unsecured creditor was paid in full prior to the commencement of the liquidation, but there are only sufficient funds to pay ordinary unsecured creditors 20 cents in the dollar).
16. However, there is a competing policy objective: there are risks to commercial confidence if transactions that appear to be normal are re-opened long after the event. Many individual creditors who receive payments that are voidable will not have engaged in any blameworthy conduct. For the most part, they will not have had anything to do with the company's difficulties, and had no knowledge or reason to know about them. Nor will they have done anything to unfairly obtain more from the

liquidation than they might otherwise have been entitled to. They will, in most cases, have spent most or all of the money they received to pay their own creditors or employees by the time they receive a voidable transactions notice from a liquidator.

17. These competing objectives mean that it is essential for the voidable transactions regime to provide a satisfactory trade-off between:
 - 17.1. protecting an insolvent company's creditors as a whole against a reduction in the assets available to them; and
 - 17.2. protecting an individual creditor, who has acted in good faith, from having a transaction set aside.
18. The Companies Act aims to provide a reasonable balance between these competing objectives by providing for liquidators to set aside transactions entered into by the debtor company, but subject to a creditor's defence. The liquidator can set aside a transaction if:
 - 18.1. the debtor company was insolvent at the time the payment was made;
 - 18.2. the payment took place no more than two years before the liquidation started; and
 - 18.3. the creditor received more than they would have received in the company's liquidation.
19. The defence states that a creditor will not have to repay the amount to a liquidator where they can prove that:
 - 19.1. the creditor acted in good faith;
 - 19.2. a reasonable person in the creditor's position would not have suspected, and the creditor did not suspect or have reasonable grounds for suspecting, that the debtor was, or would become, insolvent; and
 - 19.3. the creditor either **gave value** for the property, **or altered their position**, in the reasonably held belief that the transfer of property was valid and would not be set aside.
20. The IWG identified issues with the two year time limit, and the 'gave value' test within the creditor's defence. The IWG recommended reducing the clawback period from two years to six months for unrelated party transactions and repealing the 'gave value' test as a 'package'. These issues are discussed below.

Voidable transactions – the two year time limit

21. The IWG stated that the two year rule places a very heavy emphasis on the interests of creditors as a whole. The risks to commercial confidence are significant because businesses can be exposed to a large amount of trading over the course of any two year period. For this reason, the IWG recommended that the period of vulnerability be reduced from two years to six months in the case of transactions with unrelated parties. I agree, for the reasons the IWG identified.

- 22.** The IWG also recommended that the period of vulnerability be increased from two to four years in the case of transactions with a related party. I also agree with this recommendation. As noted by the IWG, when companies get into financial difficulty the owners know about it before other parties and can take advantage of it to harm the interests of unrelated party creditors. The two year rule provides too much scope for directors to manage the start date of a liquidation to avoid transactions with related parties being able to be clawed back.
- 23.** Reducing the time limit to six months would also be consistent with an initiative I am progressing jointly with the Minister for Small Business that aims to reduce the prevalence of extended payment terms and late payments. Once legislation comes into force, extended payment terms will be able to be deemed to be unfair (and thus prohibited) if they are imbalanced, unnecessary, and would cause detriment. This will ensure that businesses are able to start the clock on the six month voidability period sooner rather than later [CAB-19-MIN-0362].

Voidable transactions – the creditor’s defence

- 24.** There are no issues with the ‘good faith’ and ‘reasonable person’ tests within the creditor’s defence, as outlined in paragraph 19. However, the ‘gave value’ test within the third limb is controversial. A Supreme Court decision in 2015¹ means that the ‘gave value’ test is easy to meet and will almost always be satisfied. This means that people don’t need to rely on the ‘altered position’ test in order to meet the defence and that very few transactions are able to be clawed back.
- 25.** The IWG recommended repealing the ‘gave value’ test, meaning that the creditor would need to meet the alternative ‘altered position’ test. This would change the focus of the defence from whether a creditor knew the company was insolvent to whether the creditor altered their position. The IWG noted that this change would make the defence consistent with the equal treatment principle because it the ‘altered position’ test is about effects, not the creditor’s conduct.
- 26.** I agree that the current focus of the creditor’s defence (whether the creditor knew the company was insolvent) is inconsistent with the equal treatment principle. However, I do not, on balance, support the IWG’s recommendation to repeal the ‘gave value’ test. The creditor’s defence would become very difficult to meet because it can be challenging to meet the requirements of the ‘altered position’ test. Repealing the ‘gave value’ test would not give enough weight to the rights of individual creditors who have done nothing wrong.

Viewing the time limit reduction and repealing ‘gave value’ as a package

- 27.** I do not agree with the IWG’s view that the reduction in the time limit from two years to six months and repeal of the ‘gave value’ test should be viewed as a package. I consider them to be distinct issues because:
- 27.1. the change to the clawback period will affect all unrelated party creditors; but
- 27.2. the defence is only relevant to creditors:

¹ Allied Concrete [2015] NZSC 7

- 27.2.1. for whom the value of the transaction is sufficiently large to justify incurring the legal and other costs associated with challenging a liquidator's voidable transaction notice; and
- 27.2.2. who can demonstrate that they accepted payment in good faith.

Voidable charges

28. There are also clawback-type powers in relation to certain types of charges given over property or undertakings of a company. The time limit for these voidable charges should be changed from two years to six months (unrelated parties) and four years (related parties) for the reasons given in relation to voidable transactions.

Transactions at undervalue and for inadequate or excessive consideration

29. The Companies Act also provides for liquidators to claw back amounts relating to the following types of pre-liquidation insolvent transactions:

- 29.1. Transactions at undervalue (e.g. the sale of an asset with a market value of \$100,000 for \$20,000), if a company was insolvent at the time, or a company became insolvent as a consequence of entering into the transaction. The clawback period is two years regardless of whether or not the acquirer of the asset was a related or unrelated party; and

- 29.2. Transactions for inadequate consideration (where the debtor company was the seller) or excessive consideration (where the debtor company was the buyer). This provision only applies to related party transactions, for example where a company acquires services from a director's spouse or sibling at above market rates. The clawback period is three years.

30. Consistent with the IWG's recommendations, I am recommending:

- 30.1. retaining the two year time limit for unrelated party transactions at undervalue because they always harm the collective interests of creditors;

- 30.2. increasing the time limit from two to four years for related party transactions at undervalue because they often amount to a misuse of limited liability, particularly where they trigger a company's insolvency; and

- 30.3. increasing the time limit from three to four years for transactions with related parties for inadequate or excessive consideration for the same reason, i.e. they often amount to a misuse of limited liability.

Stakeholders' views

31. Almost everyone who submitted on the IWG's recommendations agreed that the two year period of vulnerability for voidable transactions is too long in relation to unrelated parties who accept payment in good faith. However, three submitters stated that the period should be reduced to 12, not 6 months, because they considered that 6 months would reduce the amounts to be clawed back by too great an amount.

32. There were split views on the 'gave value' issue. Most insolvency law experts and practitioners supported repeal. Construction industry stakeholders, in particular, supported retaining it.
33. There was general support for the proposals to extend the clawback period for the range of related party transactions to four years.

Issue B: Incentivising liquidators to pursue claims for reckless trading

34. The Companies Act includes a directors' duty relating to reckless trading. It states that a director must not agree to the business of the company being carried on in a manner likely to create a substantial risk of serious loss to the company's creditors. Claims for breaches of this duty typically only arise when a company becomes insolvent. If there has been reckless trading, then the liquidator is best placed to detect it and take a claim against the directors if doing so is likely to benefit creditors as a whole.
35. A problem with the existing law is that liquidators often do not have incentives to make reckless trading claims because there can be a mismatch between who pays the cost of making a claim and who benefits. In many cases:
 - 35.1. the costs will be met from the remaining assets of the company and, therefore, be met indirectly by unsecured creditors because there will be less for the liquidator to distribute to them; and
 - 35.2. any creditors who have security over all of the company's assets will obtain the benefits from a successful claim.
36. This can be an issue where one of more directors of the debtor company holds a general security agreement (GSA) over all of the assets of the company. There is little point in the liquidator taking a reckless trading claim against the directors if some or all of the amounts they might obtain must then be distributed to those same directors as secured creditors. The risks are particularly high where the directors (or related parties) hold a substantial portion of the secured debt of a company.
37. In order to deal with this problem, the IWG recommended amending the Companies Act to provide that recoveries from reckless trading claims will be made available to unsecured creditors only, as is the case in Australia and the United Kingdom.
38. It could be argued that this change should not be made because other non-related party secured creditors can also be the victims of reckless trading. This is mainly because reckless trading claims tend to affect the value of a business as a going concern. Therefore, a secured creditor that has based its lending decisions on the value of a company as a going concern will be exposed to losses. On this basis, secured creditors should be entitled to the proceeds of reckless trading claims.
39. Nevertheless, I agree with the IWG's proposal to limit reckless trading recoveries to unsecured creditors because this issue is not simply about winners and losers. There is a wider public interest in providing liquidators with stronger incentives to take reckless trading claims.

Stakeholders' views on reckless trading

40. Stakeholder views were more or less evenly split on whether this change should be made. Those who supported it agreed with the IWG's reasoning. Those who opposed it, including the New Zealand Bankers' Association, expressed concern about the potential adverse impacts on secured creditors that are not directors of the debtor company.

Issue C: Preferential claims

41. The Companies Act identifies the order in which payments are made – see **figure 1**, which identifies most, but not all of the 'preferential creditors' who are paid ahead of ordinary unsecured creditors.

Figure 1: Ranking of creditors under the Companies Act

Class of creditor	Reasons
1 Secured creditors	<ul style="list-style-type: none">• Facilitates the provision of secured credit• Preserves legitimate commercial expectations• Fosters predictability in commercial relationships
2 Preferential creditors have claims in the following order:	
(a) The liquidator's reasonable fees and expenses	<ul style="list-style-type: none">• Incentivises practitioners to carry out liquidations
(b) Employees - nine categories of remuneration, e.g. wages, salary, holiday pay, redundancy & KiwiSaver (capped at \$23,960)	<ul style="list-style-type: none">• Provides some protection to employees who have lost their jobs
(c) Layby sales	<ul style="list-style-type: none">• Consumer protection
(d) Company tax and GST, PAYE, resident & non-resident withholding tax deductions; and customs duties and levies	<ul style="list-style-type: none">• Protects public revenue
3 Ordinary unsecured creditors	
4 Debtor company shareholders	<ul style="list-style-type: none">• Incentivises directors to manage companies prudently

42. Preferred creditors are more likely to receive some or all of what they are owed, but at the expense of ordinary unsecured creditors, who consequentially receive less. This win-lose aspect of preferences, along with their tendency to compromise the equal treatment principle, means that they should not be created or expanded without good reason.
43. The IWG made three priority claim-related recommendations:
- 43.1. clarify whether long service leave forms part of the preferential claim for employees;
 - 43.2. add a new priority for gift cards and vouchers, ranking equally with the existing layby sales preference; and
 - 43.3. place a six month time limit on the tax and duty preference

The employee preference

44. IWG Report No. 2 noted that there is uncertainty among both insolvency practitioners and insolvency law specialists about whether long service leave is included within the scope of the employee preference. This uncertainty means that there is no uniform practice among liquidators. The IWG recommended clarifying whether it forms part of the preference, without expressing a view one way or the other.
45. Another employee-related issue was identified as a result of consultation on Report No. 2. Payments in lieu of notice are not within the scope of the preference. I am not aware of any reasons for treating payments in lieu of notice differently to redundancy payments, which are within the scope of the employee preference.
46. Both of these situations result in arbitrary and indiscriminate outcomes for employees at a time they can be facing personal financial pressure. I am, therefore, proposing to amend the employee preference:
- 46.1. to clarify that long service leave is included within the scope of the employee preference where the required amount of minimum service has already been served; and
 - 46.2. to add payments in lieu of notice to the employee preference.
47. These provisions would only apply where the entitlements are provided for under an employment agreement.
48. Clarifying and expanding the scope of this priority should not have a material impact on ordinary unsecured creditors because these circumstances do not arise frequently and, where they do, the amounts involved would usually be small. For example, the long service leave entitlement might amount to an extra week of pay for the small proportion of debtor company employees that had completed the required period of service but had not taken that leave.

Stakeholders' views

49. Most stakeholders who submitted on the long service leave issue were indifferent about whether it should be in or outside the preference. Those that did have a view stated that it should be included. The payment in lieu of notice issue has not been the subject of public consultation.

Holders of gift cards and vouchers

50. When a business enters a formal insolvency process, consumers left holding gift cards and vouchers are ordinary unsecured creditors. This will often mean that the gift card or voucher holder will receive nothing.
51. Receivers and liquidators are not required to honour gift cards and vouchers even when they decide that the business will continue to trade. Nevertheless, some insolvency practitioners have a practice of honouring gift cards as long as the consumer also spends the equivalent amount (e.g. a \$30 gift card will be honoured if the consumer also spends at least \$30). This approach was adopted in relation to Banks Shoes and Pumpkin Patch, but not Dick Smith Electronics.
52. The IWG recommended establishing a new priority for gift cards and vouchers ranking equally with the existing layby sales priority (see item 2(c) in figure 1). The IWG noted that, unlike most other classes of creditors, recipients of gift cards and vouchers cannot be expected to monitor the solvency of retailers or know that a retailer will not be able to honour the card or voucher at a later date. In addition, the amount involved is usually only a small proportion of total debt owed to all creditors. Therefore, a new priority would be unlikely to materially harm the interests of other creditors.
53. Consultation with insolvency practitioners and lawyers has revealed that it would be impractical to introduce such a priority. It would impose significant administration costs on liquidators and receivers that would be out of proportion to the typically low value of individual gift cards and vouchers. Businesses do not usually keep detailed records of who they have sold gift cards and vouchers to. In addition, the purchaser and the holder are usually two different people. This would make it challenging for insolvency practitioners to verify who has a valid claim and could delay other creditors getting paid. It could also delay the completion of receiverships, to the detriment of other creditors, because receivers are required to pay all preferential claims.
54. I have decided, therefore, not to recommend this approach. In addition, I do not favour dollar-for-dollar matching approach described above because it would deny the benefits of the change to those low income consumers who could not afford to match the value of the card or voucher. I am instead proposing to require insolvency practitioners to honour at least 50 percent of the value of any gift cards and vouchers if a business continues to trade after entering liquidation or being put into receivership.
55. Consumers will continue to be entitled to be paid as ordinary unsecured creditors where the business stops trading.

Stakeholders' views

56. My proposed approach has not been the subject of public consultation. However, officials have discussed this proposal with some insolvency practitioners. They have advised that this obligation would be unlikely to impact on their decisions about whether to continue trading or close a business immediately. However, it could impact on any decision to do so if there were to be a requirement to honour the amount in full.

Tax and duty priorities

57. The IWG recommended imposing a six month time limit on the preferential claim for amounts unpaid to Inland Revenue (e.g. unpaid income tax, GST and withholding payments) and Customs (customs duty). The main consequence of this change would be that Inland Revenue and Customs would become ordinary unsecured creditors in relation to older debts.
58. The IWG's rationale was that Inland Revenue was better placed than other creditors to detect insolvency at an early date. This is because a company that is financially distressed often defers or stop paying taxes first, and Inland Revenue has extensive protections such as information-gathering powers that are not available to other creditors.
59. I do not support this proposal for the following reasons:
- 59.1. the revenue agencies will usually not have enough information within six months to make informed judgements about whether a debtor company should be liquidated or given additional time to pay
 - 59.2. a six-month time limit could incentivise Inland Revenue and Customs to seek to liquidate some companies that could trade their way out of difficulty, given the opportunity. In the case of Customs, the majority of managed debt is older than six months.
 - 59.3. a six-month time limit could have a negative impact on Crown revenue, of up to \$100m over a four-year period
 - 59.4. there is no evidence that Inland Revenue or Customs are generally complacent about monitoring debtors and collecting debts.

Greater transparency about tax and duty debt

60. There is a potential problem for unsecured creditors in connection with tax and duty priorities. This issue can arise because Inland Revenue and Customs have statutory obligations to not disclose the existence or amount of a company's unpaid tax or duty debt.
61. Consequently, indebted companies can be incentivised to first stop paying taxes and duties (including not filing GST returns and other returns) while continuing to pay suppliers and employees. This can provide directors with incentives to trade on even though there may be few if any prospects of the company trading its way out of insolvency.

62. Ordinary unsecured creditors, particularly trade creditors, will sometimes provide credit (and in some cases extend their trade credit) to a company without knowing that it owes a significant amount of tax or duty. It is often the case that unsecured creditors will not become aware that a company is insolvent until Inland Revenue petitions the High Court for a liquidator to be appointed.
63. The preference claim rules mean that the Crown will likely receive most or all of what it is owed, while ordinary unsecured creditors are likely to be left out-of-pocket. There can, on occasions, also be a 'domino' effect, whereby the insolvency of one company can lead to the insolvency of other businesses.
64. I am recommending that MBIE, Inland Revenue and Customs be invited to undertake policy development on improving the availability of tax and duty debt information (such as a tailored information disclosure regime) aimed at better supporting unsecured creditors, with a view of outlining potential policy options in a discussion document for release in late 2020.

Minor and technical amendments

65. I am proposing 21 other amendments to the *Companies Act 1993*, *Receiverships Act 1993* and *Insolvency Act 2006*. These proposals, which have been drawn from IWG recommendations and submitters' responses, are set out in **Annex 1**.

Amendments to the Insolvency Act 2006

66. Personal insolvency is regulated under the Insolvency Act 2006. Many of the rules that apply to corporate and personal insolvency law (including the voidable transactions and preferential claims rules) are the same or similar. Hence, many of the Companies Act changes outlined in this paper should also be made to the Insolvency Act in full or in part. The right hand column of the table in Annex 1 identifies which of the recommended changes to the Companies Act have implications for the Insolvency Act.

Ponzi schemes

67. A Ponzi scheme is a fraudulent investment scheme promising high rates of return with little risk to investors. The scheme operator will pay the promised high rates of return to early investors from capital added to the scheme by new investors and from additional investments made by existing investors. However, this approach cannot be sustained, leading to the collapse of the scheme, often with substantial losses to investors.
68. In *McIntosh v Fisk* the Supreme Court issued a majority decision in May 2017 under the voidable transactions provisions in relation to an investor who had withdrawn from the Ross Asset Management Ponzi scheme 9 months before it collapsed. The Court stated that the investor could retain the capital he had withdrawn, but needed to pay the fictitious profits plus interest to the liquidator.
69. This decision means that Ponzi scheme investors bear different proportions of total losses depending on whether they had withdrawn all of their investment, some of their investment, or not withdrawn anything. Those who have withdrawn nothing

incur the greatest losses proportionately.

70. MBIE released a discussion document in 2018 on the issues with applying the voidable transactions regime to Ponzi schemes [DEV-18-MIN-0058]. It also proposed a bespoke regulatory solution that would have provided for more equitable treatment of different classes of investors.
71. I have since put this work on hold, for two reasons. First, I did not want to delay progress on the reforms outlined in this paper, which taken together, will significantly improve insolvency law.
72. Second, most submitters did not consider it to be a high priority issue. Although many submitters acknowledged that there are issues with applying the voidable transactions regime to Ponzi schemes, the detriments associated with retaining the status quo are relatively low because:
- 72.1. there are very few Ponzi schemes. There have been one or two a year, on average, over the last decade;
 - 72.2. the costs of a bespoke regime could be out-of-proportion to the size of the problem; and
 - 72.3. although the proposed regime would be fairer, the law is clear, so liquidators know what they are required to do and investors know where they stand.
73. I note that my proposal, earlier in this paper, to reduce the period of vulnerability from two years to six months under the voidable transactions regime will reduce the amount clawed back from investors who withdrew funds from a Ponzi scheme. This will have the effect of reducing the amount available to be shared amongst other investors and, therefore, increase the differences in the losses between different classes of investors.

Consultation

74. The following departments and other public sector agencies were consulted on this paper: Treasury, Inland Revenue Department, New Zealand Customs Service, Ministry of Justice, Financial Markets Authority, Reserve Bank of New Zealand, Official Assignee, and Parliamentary Counsel Office.
75. Feedback was obtained by way of public consultation on IWG Report No. 2.

Financial Implications

76. The proposals in this paper have no financial implications.

Legislative Implications

77. Confidential advice to Government

78. The Bill will amend three Acts, two of which bind the Crown: the Companies Act

1993 and the Insolvency Act 2006. The Receiverships Act 1993 does not include such a provision.

79. I am seeking agreement in this paper for an exposure draft of the Bill to be released for public comment. I consider it likely that insolvency practitioners and insolvency law specialists, in particular, will be able to suggest material improvements to the Bill before it is introduced.

Impact Analysis

80. MBIE's Regulatory Impact Analysis Review Panel has reviewed the attached Regulatory Impact Summaries prepared by MBIE. The Panel considers that the information and analysis summarised in the Regulatory Impact Summaries meet the criteria necessary for Ministers to make informed decisions on the proposals in this paper.
81. Based on the information provided, the Regulatory Quality Team at The Treasury confirms that no Regulatory Impact Assessment is required in support of the proposals in Annex One, since they are expected to have only minor impacts on individuals, businesses and not-for-profit entities.

Human Rights

82. The proposals in this paper are consistent with the *New Zealand Bill of Rights Act 1990* and the *Human Rights Act 1993*.

Gender implications

83. The proposals in this paper have no gender implications.

Disability Perspective

84. The proposals in this paper have no disability implications.

Publicity

85. I will issue a press statement announcing the main decisions in this paper.

Proactive Release

86. I will direct officials to release this Cabinet paper with appropriate redactions.

Recommendations

The Minister of Commerce and Consumer Affairs recommends that the Committee:

1. **Note** that most of the substantive recommendations in this paper were recommended by the Insolvency Working Group, comprising an independent chair, four industry experts, a credit industry representative and a representative of the Official Assignee;
2. **Note** that the terms of reference and membership of the Insolvency Working Group were approved by Cabinet in 2015 [EGI-15-MIN-0096 and APH-15-MIN-0109 refer];

Voidable transactions and other recoveries

3. **Note** that the Companies Act 1993 provides for liquidators to set aside certain types of debtor company transactions either two or three years prior to the liquidation being commenced, if the company was insolvent at the time the transaction took place;
4. **Note** that the consequences of a transaction being set aside is that the liquidator can claw back amounts from the other party to the transaction;
5. **Agree** to the following in relation to the periods of vulnerability prior to the commencement of the liquidation for clawbacks:
 - 5.1. reduce the period from two years to six months for voidable transactions with unrelated parties;
 - 5.2. increase the period from two to four years for voidable transactions with related parties;
 - 5.3. in relation to unrelated parties, reduce the period from two years to six months for voidable charges over property or undertakings of the debtor company
 - 5.4. in relation to related parties, increase the period from two years to four years for voidable charges over property or undertakings of the debtor company
 - 5.5. retain two years for transactions at undervalue with unrelated parties;
 - 5.6. increase the period from two to four years in relation to transactions at undervalue with related parties;
 - 5.7. increase the period from three to four years in relation to transactions for inadequate or excessive consideration;
6. **Note** that there is a creditor's defence, in relation to voidable transactions only, which states that a court must not order the recovery of property if the creditor proves that:
 - 6.1. they acted in good faith;
 - 6.2. a reasonable person in their position would not have suspected and did not have reasonable grounds for suspecting that the debtor company was or would become insolvent; and

- 6.3. they gave value for the property or altered their position in the reasonable held belief that the transfer of property was valid and would not be set aside;

Reckless trading

7. **Note** that insolvency practitioners can be deterred from taking reckless trading claims because the costs will be borne by unsecured creditors, but the benefits will accrue to any creditors that have security interests over the assets of the debtor company;
8. **Agree** that recoveries from reckless trading claims should be for the benefit of unsecured creditors only;

Preferential claims

9. **Agree** to make the following changes to the existing preferential claim for employees of the debtor company:
 - 9.1. clarify that long service leave is included within its scope;
 - 9.2. add payments in lieu of notice to its scope;
10. **Agree** to require insolvency practitioners to honour at least 50 percent of the value of gift cards and vouchers, if the company continues to trade after being placed into receivership or liquidation;
11. **Agree** to not impose a time limit on the existing Inland Revenue Department and New Zealand Customs Service preferences relating to unpaid tax and customs duties and levies;

Discussion document

12. **Agree** that officials from the Ministry of Business Innovation and Employment, the Inland Revenue Department and New Zealand Customs Service undertake policy development that seeks to improve the availability of tax debt information and outline potential policy options in a discussion document in 2020;

Ponzi schemes

13. **Note** that work on a possible regulatory solution for sharing losses among Ponzi scheme investors has been put on hold to avoid delaying progress on the reforms outlined in this paper;

Minor and technical changes

14. **Agree** to the changes described in Annex 1;
15. **Authorise** the Minister of Commerce and Consumer Affairs to make minor additional policy decisions and technical changes, consistent with the policy intent of this paper, on issues that arise in drafting and passage;

Personal insolvency law

16. **Note** that many of the rules applying to corporate insolvency under the Companies Act 1993 and personal insolvency under the Insolvency Act 2006 are the same;
17. **Agree** to make equivalent changes in the Insolvency Act to:
 - 17.1. recommendation 5, relating to periods of vulnerability;
 - 17.2. recommendations 10-11, relating to preferential claims;
 - 17.3. the changes specified in the right hand column of the table in Annex 1;

Legislative implications

18. **Agree** to give effect to the above proposals through the Insolvency Law Reform Bill, which holds a Confidential advice to Government
19. **Invite** the Minister of Commerce and Consumer Affairs to issue drafting instructions to the Parliamentary Counsel Office to give effect to the agreed changes;
20. **Authorise** the Minister of Commerce and Consumer Affairs to release an exposure draft of the Bill for public comment; and

Publicity

21. **Note** that the Minister of Commerce and Consumer Affairs will issue a press statement in relation to the matters covered by this paper.

Authorised for lodgement

Hon Kris Faafoi

Minister of Commerce and Consumer Affairs