IN CONFIDENCE

OFFICE OF THE MINISTER OF COMMERCE AND CONSUMER AFFAIRS

The Chair
Cabinet Economic Growth and Infrastructure Committee

Insolvency practitioners and voluntary liquidations

Proposal

1 This paper seeks approval to improve the regulation of insolvency practitioners through enhancements to the Companies Act and Receiverships Act and the introduction of a co-regulatory licensing system.

Executive Summary

2 On 14 October 2015 EGI noted that I intended to establish an Insolvency Working Group (**IWG**) to consider various issues relating to corporate insolvency law [EGI-15-MIN-0096]. IWG Report No. 1, which was finalised in July 2016, covers two of the four issues covered by the terms of reference: the regulation of insolvency practitioners and voluntary liquidations. There has since been public consultation on Report No. 1 and I now seek Cabinet decisions.

3 There are two critical issues to consider: the regulation of insolvency practitioners and the treatment of voluntary liquidations.

The regulation of insolvency practitioners

4 The main aim of corporate insolvency law is to provide incentives for any assets of a failed company to be allocated to their most efficient use. The company should be rehabilitated if it is viable. If not, it should be liquidated, the assets realised and distributed to creditors in accordance with rules in the Companies Act, with a minimum of delay and expense.

5 Insolvency practitioners have a significant impact on whether those outcomes are achieved. The quality of an administrator's advice can impact on whether a business is rehabilitated or liquidated. Liquidators and receivers make decisions which impact on the total amount available for distribution to creditors. All practitioners are placed in a position of managing and protecting other people's money and property. Consequently, insolvency practitioners must act honestly, fairly and impartially at all times, and avoid conflicts of interest.

6 Several practitioners fall well short of expected standards. A small number use their statutory powers to misappropriate money that should go to creditors. For example, in a court case earlier this year, a liquidator was found to have forged a document and did not account for receipts of $540,000. More commonly, there are 'self-interested' practitioners who overcharge for their services or carry out unnecessary work in order to obtain larger fees. There are 'debtor-friendly' liquidators who fail to comply with their statutory duty to protect the interests of creditors. There is also a wider issue with the quality of insolvency practice and a consequential need to raise professional standards.

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7 I am proposing that Cabinet agrees to the two main sets of recommendations made by the IWG to address these problems:

7.1 Strengthen provisions in the Companies Act 1993 and Receiverships Act 1993. Those changes would, among other things, add to the list of practitioner disqualifications, strengthen creditors' powers in relation to the appointment and replacement of insolvency practitioners, and provide the High Court with workable powers to remove and/or ban incompetent, dishonest and unprofessional practitioners.

7.2 Introduce a co-regulatory licensing system. Professional bodies would carry out the frontline regulation and the Registrar of Companies (**Registrar**) would monitor and report on the adequacy and effectiveness of the frontline regulators' regulatory systems and processes.

8 I am also proposing that the Registrar would be empowered to prevent non-trivial proposals to alter and add to the licensing system, on public interest grounds. This provision will guard against frontline regulators imposing excessive barriers to entry and imposing unnecessary regulatory systems and processes.

9 I am satisfied that licensing/co-regulation will not harm competition in the regions. Information obtained as part of consultation on IWG Report No. 1 shows that the number of practitioners in the regions is already low, practitioners operate outside their home towns, practitioners' industry specialisation matters more than their location and Big 4 and mid-tier accounting firms obtain local market knowledge through their national networks.

10 I am not recommending the alternative of statute-backed licensing by the accounting profession under the New Zealand Institute of Chartered Accountants Act 1996 (NZICA Act) for two reasons. First, there are higher risks of over-regulation absent independent oversight. Second, such a licensing regime could exclude people who should not be excluded. About 20 percent of reliable insolvency practitioners are not Chartered Accountants.

Voluntary liquidations

11 The main issue with voluntary liquidations relates to company directors who defeat the interests of creditors through phoenix activity (e.g. by disposing of the assets of the company to an associated party at undervalue or no value). The Inland Revenue Department, which is the largest creditor organisation in New Zealand, advises that they see numerous instances of this form of conduct.

12 There is a comprehensive range of anti-phoenixing measures in the Companies Act and other legislation. However, many of those tools are only effective if the liquidator is prepared to use them. Unfortunately some liquidators make a living by promoting themselves as debtor-friendly. Never using the claw back and other anti-phoenixing tools and not enforcing directors' duties are elements of fostering such a reputation.

13 I agree with the IWG that the insolvency practitioner-related proposals outlined in paragraph 7 above will help address the problems associated with phoenixing.

Background – The principles of insolvency law

14 There are two fundamental principles of insolvency law: equal sharing between creditors (also called the *pari passu* principle) and having collective orderly processes during the formal insolvency administrations. These two principles are interdependent: equal sharing distribution requires that all creditors be seen as one entity.

15 The alternative to an orderly process would be a free-for-all where creditors are involved in a race to the courts to pursue their rights against the debtor company and enforce the resulting court decisions. This would be highly unsatisfactory for the following reasons:

15.1 The debtor company's assets would be wasted in defending multiple court actions from individual creditors, and creditors would incur unnecessary litigation-related costs;

15.2 It would be unfair on creditors who 'came too late' to the race because they would have a right to enforce their claims, but there will be no assets to enforce them on; and

15.3 It would be unfair on creditors who are owed small amounts and consequentially decide not to litigate.

The implications of collectivity for regulating insolvency practitioners

16 The imperative to have collective processes has important implications for the regulation of insolvency practitioners. The creditors of a company that is placed in an insolvency administration lose their rights to enforce their contracts once the practitioner is appointed, either temporarily (in the case of receiverships and voluntary administrations) or permanently (in the case of liquidations). Individual creditors instead have no choice other than to rely on the insolvency practitioner to protect the collective interests of creditors.

17 It is equally important, therefore, for the State to provide the commercial community with a high level of assurance that insolvencies will be administered in a professional manner. This is the case most of the time with most of the hundred or so practitioners who regularly take appointments. However, it appears that there are 10 to 20 practitioners at any one time who consistently fall below reasonable expectations.

Practitioners' statutory duties, rights and powers

18 The collectivity principle also means that insolvency practitioners have extensive statutory powers to carry out the insolvency efficiently and effectively. The resulting control insolvency practitioners have over other peoples' assets necessarily means that they have statutory duties. For example, the principal duty of a liquidator is to carry out the following activities in a reasonable and efficient manner:

18.1 To take possession of, protect, realise and distribute the assets, or the proceeds of the realisation of assets of the company to its creditors; and

18.2 If there are surplus assets remaining after paying creditors in full, to distribute them, or the proceeds of the realisation of assets in accordance with the company's constitution or in accordance with the Companies Act.

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19 In addition, the liquidator's own 'properly incurred' fees and expenses have a priority ranking above all creditors other than secured creditors. Having this priority is essential because without it practitioners would not have incentives to administer insolvent liquidations. However, the priority is open to abuse. There are some practitioners whose fees and expenses often equate to whatever amount is available after secured creditors have been paid.

The status quo in relation to the regulation of insolvency practitioners

20 There is no statutory occupational regulation system for insolvency practitioners. There are some minimal statutory disqualification provisions, but almost everyone who is at least 18 years old, is not an undischarged bankrupt and has not been certified under mental health legislation is eligible to be a liquidator, receiver or administrator. There are some dishonesty conviction-related provisions but they are not comprehensive. For example, a person convicted of a crime of dishonesty under the Crimes Act 1961 is not disqualified. Nor is a person convicted of tax evasion and other serious forms of knowledge-based criminal offending under the Tax Administration Act 1994.

21 The courts have order-making powers to supervise liquidations, enforce liquidators' statutory duties, and prohibit a person from being a liquidator. However, creditors have few economic incentives to seek to enforce the duties, particularly in relation to practitioners who liquidate SME companies. The prohibition-making power is ineffective because it is complex, time-consuming and difficult to use.

22 The Recovery, Insolvency and Turnaround Association of New Zealand (RITANZ) and Chartered Accountants Australia and New Zealand (CAANZ) have a voluntary accreditation regime which is in its infancy. It hooks into the regulatory system that CAANZ is required to operate under the New Zealand Institute of Chartered Accountants Act 1996 (NZICA Act). 74 of the 95 accredited insolvency practitioners are Chartered Accountants. Five are lawyers. The other 16 have met the competence requirements of the accreditation system through an alternative work experience-only criterion.

23 About 55 percent of accredited insolvency practitioners are based in Auckland and a further 25 percent in Christchurch or Wellington. There is no evidence that the concentration of accredited practitioners in the three major cities harms competition in the regions. Price and relevant industry experience are two of the three major factors that experienced creditors consider when deciding who to seek to appoint. Local knowledge is the other main issue. However, the Big 4 and mid-tier accounting firms have national networks, so the engagement partner can obtain local knowledge from personnel in other offices.

There is an Insolvency Practitioners Bill in the House

24 The Insolvency Practitioners Bill was introduced in 2010 and proposed the following:

- 24.1 To empower the Registrar of Companies to restrict or prohibit certain individuals from providing corporate insolvency services (i.e. negative licensing); and
- 24.2 To broaden the range of automatic disqualifications.

25 Considerable opposition was expressed to the negative licensing proposal at the Commerce Select Committee, mainly because it did not provide a means of doing anything about practitioner dishonesty and incompetence until after the damage was done. The Committee reported the Bill back with the following changes:

25.1 A registration system that included stronger disqualification criteria. However, it did not provide for an independent regulator to test a person's competence and honesty as a condition of obtaining registration; and

25.2 Enhancements to practitioners' duties, and additional offence provisions.

26 The Bill had a second reading on 7 November 2013 but it has since been on hold. The IWG expressed concern in Report No. 1 that registration will not stop unsatisfactory practitioners from entering or participating in the market.

27 The IWG also stated that registration would be worse than the status quo because it is likely to mislead company shareholders, directors and creditors who are not regular users of insolvency services. The IWG noted that it is not unreasonable for the public to assume that if a person's name appears on a public register, then an independent regulator will have first verified that he or she meets certain minimum standards of honesty and competence.

28 I agree with these concerns about registration.

The market for insolvency services

29 Most insolvency engagements are accepted by practitioners within 10 to 12 firms comprising the 'Big 4' accounting firms, some mid-tier accounting firms and boutique practices that specialise in insolvency, recovery and turnaround services. There are also numerous small firms or sole practitioners, some of whom take large or moderate numbers of appointments, while others take the occasional liquidation appointment.

30 There were about 2,500 appointments (including solvent liquidations) in the year to August 2016 and:

30.1 About one third were accepted by partners of PwC, KPMG and Deloitte;

30.2 About a quarter were accepted by seven individuals within three firms: four from PwC, two from KPMG and one from Shephard Dunphy;

30.3 83 practitioners accepted 10 or more engagements; and

30.4 A significant number of liquidations were administered by practitioners with convictions under the Crimes Act and/or the Tax Administration Act 1994. Two of them (John Gilbert and Imran Kamal) accepted 98 appointments between them.

31 The Official Assignee is appointed by the High Court to administer around 10 percent of company liquidations. These are liquidations that the private sector does not want to do because the prospects of being paid are poor. Of the remainder, the company's shareholders or directors make 50-60 percent of the appointments and the High Court makes the remaining 40-50 percent.

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32 Inland Revenue is a creditor in about 95 percent of insolvent liquidations and makes the largest number of liquidation applications to the Court, by far. Inland Revenue is often among the first creditors not to be paid because companies with liquidity problems have incentives to keep paying trade creditors and employees so that they can continue to trade.

33 Banks are relatively infrequent applicants for two reasons. First, they will consider appointing a receiver if there is security for the lending and a sufficiently large amount is at stake. Second, they typically hold guarantees and mortgages over the homes of SME company shareholders, so they can sell the house.

34 Major trade creditors are often able to protect their interests by requiring personal guarantees or taking security over a family trust as a condition of doing business.

35 Most unsecured creditors owed relatively small amounts have few if any financial incentives to apply. It costs about $3,000 to obtain an order to appoint a liquidator and in many cases it will be good money chasing bad. The creditor cannot carry out a reliable cost-benefit analysis because of uncertainties about how much other creditors are owed. All that they may know is that the prospects of recovering more from the liquidation than their costs of seeking a court order are likely to be low because unsecured creditors often only obtain a dividend of a few cents in the dollar, or nothing at all.

36 Banks are responsible for the majority of receiver appointments. The remainder are made by private security holders.

Problems

37 The problems with the status quo can be broadly described as:

37.1 dishonesty, debtor-friendliness and incompetence in connection with SME company liquidations; and

37.2 substandard performance in relation to the full range of insolvency administrations.

Dishonesty, debtor-friendliness and incompetence

38 There is no evidence of dishonesty, debtor-friendliness and incompetence of sufficient scale to justify government intervention in relation to:

38.1 major corporate insolvencies;

38.2 administrators and deed administrators appointed under the voluntary administration regime;

38.3 receivers appointed under the Receiverships Act;

38.4 the administration of compromises; or

38.5 liquidators appointed by the High Court.

39 Those who make those appointments, or make application to the courts, have incentives to select capable and reputable practitioners. They also tend to have a good understanding of the market for insolvency services.

40 The problems are concentrated in the SME company liquidation part of the market. Examples of unsatisfactory conduct found primarily in that area include:

40.1 Egregious conduct, i.e. activity that is tantamount to theft from creditors. For example, in July 2016, the High Court found that Geoff Smith had forged a document and did not account for receipts of $540,000.

40.2 Liquidators putting self-interest ahead of their statutory duties to creditors by, for example, charging excessive fees and doing unnecessary work to generate additional fees.

40.3 Placing the interests of the company's directors and shareholders ahead of their statutory duties to creditors. These 'debtor-friendly' liquidators do not seek to recover transactions at undervalue or for inadequate or excessive consideration, or enforce directors' duties.

41 These problems are concentrated in the SME company liquidation part of the market because:

41.1 the shareholders' investments in the company are gone, so they do not have financial incentives to select a good liquidator. In addition, many of them do not understand the market because are not regular buyers of insolvency services. Thus, dishonest and self-interested practitioners are able to make a living by marketing their services to indifferent and unsuspecting directors and shareholders;

41.2 directors who engage in unlawful activity (e.g. by selling the company's assets to a related party at undervalue) have a conflict of interest. They have incentives to appoint a debtor-friendly liquidator in order to avoid the risks of legal claims against themselves; and

41.3 the amounts owed to individual creditors by SME companies are usually not large enough to provide financial incentives to monitor liquidators' performance or incur the expense of seeking remedies from the courts.

42 There are often no clear distinctions between incompetence, dishonesty and debtor-friendliness. There are, perhaps, 10 to 20 such practitioners at any one time that engage in some or all of the practices described above, including up to five who are grossly dishonest.

Wider practitioner performance issues

43 This problem is mostly associated with practitioners who lack the skills, training and experience to complete the work to a high standard. Among other things, these problems may arise because the practitioner:

43.1 does not have sufficient understanding of insolvency legislation and case law;

43.2 is not very skilled in professional judgment matters such as deciding whether to sell the company's assets as a package or individually, or identifying the best potential buyers; and

43.3 does not have sufficiently good processes and systems within his or her practice to efficiently manage insolvency administrations.

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44 There are also wider concerns about general standards of insolvency practice. That said, standards are likely to arise over time under the RITANZ/CAANZ accreditation scheme with or without a government licensing regime. However, those improvements are only likely to occur in relation to the 95 practitioners who have chosen to join the scheme. There are, perhaps, another five to ten competent practitioners who regularly take appointments but have not joined.

45 There are also issues in relation to individual practitioners who make mistakes or errors of judgment. While these lapses may not indicate systematic incompetence or unprofessionalism, there is little accountability in relation to practitioners who are not members of a professional body.

Solutions

46 Four options are discussed in the accompanying Regulatory Impact Statement. The key choice is between two of them: to only implement what is described as Solution A below, or to implement both Solution A and Solution B. Solution A alone will achieve significant benefits. Solution B will provide further benefits, but with additional costs. I am proposing that both solutions be adopted.

47 **Solution A**: Improve the existing Companies Act and Receiverships Act provisions by making the 34 changes listed in Annex One of this paper. Most of them are already in the Insolvency Practitioners Bill as reported back by the Commerce Committee in 2011 and were recommended by the IWG to be progressed. The most important involve:

47.1 *Table 1 (items 1-2)*: Improve the list of automatic practitioner disqualifications by making the list of dishonesty-related convictions complete and modifying and adding to the list of conflict-of-interest disqualifications.

47.2 *Table 4 (item 31)*: Provide the High Court with an efficient and effective means to disqualify and ban insolvency practitioners. The Court nominally has this power at present. However, it has never been successfully used, mainly because the process is convoluted and would take several months to complete (time is usually of the essence). The main problem is a 'two-strikes' rule. The Court first has to make an order stating that the liquidator has failed to comply with a duty. It is only if that order is breached that the Court can impose a second order removing the liquidator from office or making a prohibition order. There is also a 'persistent failure' test in relation to prohibition orders.

47.3 *Table 5 (item 32)*: Make it much more difficult for debtor-friendly practitioners to be appointed. The debtor company would no longer be able to appoint liquidators and administrators from the date of service of a liquidation application by a creditor, except with the applicant creditor's consent.

47.4 *Table 6 (item* 33): Void the transfer of a company's assets once a liquidation application has been filed, subject to certain exceptions. This change will make it much more difficult for company directors to give effect to transactions at undervalue.

48 **Solution B**: The introduction of a co-regulatory licensing regime with the following features:

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48.1 Professional bodies would carry out the frontline regulation. This would mean, in a real sense, that the RITANZ/CAANZ accreditation scheme will be modified and become the frontline regulatory system. Entry by competing professional bodies would not be precluded.

48.2 The Registrar of Companies would monitor and report on the adequacy and effectiveness of the frontline regulators' systems and processes. The Registrar would also be charged with guarding against over-regulation by the frontline regulators.

49 Table 1 outlines the benefits. The middle column describes the benefits of only making the Companies and Receiverships Acts improvements. The right hand column describes the extra benefits associated with co-regulation/licensing.

50 To summarise, co-regulation/licensing will provide additional means of dealing with incompetent and unprofessional liquidators. It also has the capacity to improve general standards of insolvency practice over time. The addition of a fit and proper person test, along with subjecting all practitioners to professional and ethical standards, and a readily accessible complaints, investigation and disciplinary system are all likely to contribute to this.

51 The additional cost of co-regulation/licensing will be from $750,000 to $1 million a year. This amount relates predominantly to the costs of independent oversight. It is based on information provided by the Financial Markets Authority in relation to its oversight responsibilities under the Auditor Regulation Act 2011. There are similarities both in terms of the nature of the oversight function and the size of the profession being regulated.

52 A significant part of the cost of oversight arises due to a need to have staff or contractors with relevant private sector work experience at a senior level.

Table 1: Benefits of strengthening measures plus co-regulation

Problem	Solution A: The benefits of the Companies Act and Receiverships Act changes alone	Solution B: The additional benefits by also having co-regulation
Egregious conduct	• This solution includes ensuring that the list of dishonesty-related disqualifications is comprehensive. Crimes of dishonesty under the Crimes Act and serious knowledge-based offending under tax legislation both need to be added. • It would also provide an after-the-event remedy by providing the High Court with workable liquidator removal and banning powers.	The outcomes would be very similar, compared with Option A.
Self-interested liquidators and debtor-friendly liquidators	The following measures will significantly reduce the risks: • Only permitting the debtor company to appoint a liquidator after service of a liquidation application with the approval of the petitioning creditor.	• Option A is unlikely to provide a sufficiently reliable means of dealing with more subtle forms of unprofessional conduct (e.g. overcharging and not seeking to claw back transactions at undervalue). Option B provides additional benefits in this regard

Problem	Solution A: The benefits of the Companies Act and Receiverships Act changes alone	Solution B: The additional benefits by also having co-regulation
	• Reducing phoenixing opportunities by placing a restriction on the transfer of assets once a liquidation application has been filed. • Adding new conflict-of-interest prohibitions. • Establishing a new administrative power for the Registrar to ban practitioners. • Replacing a wholly ineffective court banning power with a power that can work.	because this type of conduct will be at risk the regulator's professional and ethical standards. • A frontline regulator can more readily make orders involving ongoing monitoring and supervision. For example, a regulator can require a licensee to work under the supervision of another practitioner, or undertake a course of study.
Competence issues/poor decision-making	Option A will have little impact. The only significant improvement will be to exclude dishonest and debtor-friendly liquidators who are also incapable.	• The quality of insolvency practice should be higher as a result of applying continuing professional development rules and practice review processes to all practitioners, not just those who choose to be accredited by RITANZ/CAANZ. • There will be some additional gains as a result of being able to apply enforcement processes to practitioners who make questionable professional judgments.

Increasing creditors' powers – The Inland Revenue panel

53 Inland Revenue would make more appointments than they already do as a consequence of the proposal referred to in Table 1 to only permit the debtor company to appoint a liquidator after service of a liquidation application with the approval of the petitioning creditor.

54 There is a potential competition issue in connection with this change. Inland Revenue only engages practitioners from three firms: PwC, KPMG and Deloitte. There is a risk, therefore, that increasing creditors' powers will increase market concentration and make it more difficult for smaller firms to compete on their merits. This will particularly be a risk for firms that obtain most or all of their work through director and shareholder appointments.

55 Inland Revenue agrees that this is an issue. Inland Revenue will review its requirements for liquidation services in light of decisions made by Cabinet.

Scope of licensing

56 There are four issues relating to the scope of the proposed licensing regime. These issues relate to compromises, trustees under the Insolvency Act, solvent liquidations, and residency issues. These matters are discussed below.

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Compromises

57 The Companies Act provides for an insolvent company to continue to operate by agreeing a compromise agreement with its creditors. A compromise arises when a company and its creditors reach an agreement cancelling all or part of the company's debts, varying the rights of its creditors or the terms of the debt, or altering the company's constitution in ways that affect the likelihood of the company being able to pay a debt.

58 The compromise system provides a simple and flexible alternative to other statutory insolvency processes. The simplicity arises in large part because the Companies Act does not prescribe an office or role of 'compromise trustee' or set out any specific duties, rights or powers of the person who designs or manages the compromise.

59 The IWG recommended against including compromises within the scope of the licensing regime largely out of concern that the simplicity and flexibility benefits would be lost and people would be discouraged from using them. It would necessarily mean that an office of 'compromise trustee' would need to be created, the role would need to be defined, and duties, rights and powers would need to be added. This will fundamentally change the nature of a compromise and discourage people from using it.

60 Several submitters disagreed, noting that compromise managers often handle other people's money and that recovery and turnaround expertise was often needed. That may be so. However, I agree with the IWG for the reasons they gave and because there is no evidence of market failures in connection with compromises.

Trustees under the Insolvency Act

61 The Insolvency Act 2006 regulates personal insolvencies. It provides for the Official Assignee to administer all but one type of personal insolvency process. The exception relates to an insolvent person's proposal to creditors for the payment or satisfaction of his or her debts. The trustee gives effect to a proposal that has been approved by a special majority of creditors and confirmed by the High Court. This involves taking control of the property that is subject to the proposal, and administering and distributing the property according to the terms of the agreed proposal.

62 The IWG recommended that trustees of insolvent persons' proposals should be included. I agree. The office already exists, so subjecting it to the licensing system will not fundamentally change the nature of the process or discourage its use.

63 Submitters in favour of licensing generally supported this proposal.

Solvent liquidations

64 There are two arguments for excluding solvent liquidations. First, they do not usually raise complex issues. Many solvent companies are liquidated simply because a business has been sold, closed down or reorganised for tax and/or management purposes. Second, the directors and shareholders must both make solvency-related resolutions before the liquidation can commence. Thus, there are no creditors' interests to be protected as long as the judgments made by the directors and shareholders are correct.

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65 The IWG concluded that there was no need to reserve solvent liquidations to licensed practitioners for these reasons. I agree.

66 I also agree with the IWG that solvent liquidations should only be able to be carried out by a lawyer or an accountant who is a member of a professional body. This is needed because the judgments made by the directors and shareholders as to solvency might have been wrong, or circumstances may have changed, in which case the engagement should immediately be transferred to a licensed insolvency practitioner. This system will only be fully effective if the person carrying out what was earlier thought to have been a solvent liquidation is subject to professional and ethical standards.

67 Most stakeholders who commented on this matter supported this approach, although some stated that solvent liquidations should be reserved to licensed insolvency practitioners.

Residency issues

68 On occasions an overseas-based practitioner (almost always an Australian) is appointed to administer an insolvency process relating to a New Zealand company. Dick Smith Electronics is an example. This Australian group of companies included one New Zealand subsidiary. Australian practitioners were appointed as administrators and receivers for the group, including the New Zealand subsidiary.

69 Several submitters noted that many other jurisdictions have a residency requirement for obtaining a licence and that such a requirement should also be imposed in New Zealand. Their main arguments were to the effect that:

69.1 overseas-based practitioners generally do not understand New Zealand legal settings and market conditions. Therefore creditors lose out because the overseas appointee wastes time and money obtaining professional advice on the local issues they do not understand;

69.2 there may be concerns about accountability through the New Zealand courts if the practitioner resides overseas; and

69.3 it would simplify the licensing system because there would be no need for the Registrar of Companies to license overseas practitioners.

70 I am not convinced that there are sufficient concerns to justify a blanket prohibition on non-residents. Furthermore, there is potential to unnecessarily restrict competition. It would be more proportionate to provide the Registrar with the power to recognise practitioners from particular overseas jurisdictions on the basis of an assessment of that jurisdiction’s regulatory regime.

71 It would also be difficult to justify a blanket prohibition on non-resident practitioners under some free trade agreements, and New Zealand’s obligation under the General Agreement on Trade in Services to not impose unnecessary barriers to trade in services.

International norms

72 Introducing licensing will mean that New Zealand is no longer an international outlier. The jurisdictions that New Zealand usually compares itself to (e.g.

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Australia, United Kingdom, Singapore and Canada) all either have licensing regimes or tightly control liquidator appointments through the courts.

A register of licensed practitioners

73 There will need to be a register of licensed practitioners. I envisage that it will be similar to the register maintained by the Registrar of Companies under the Auditor Regulation Act 2011. Insofar as, it applies to New Zealand licensees, the register of licensed auditors is simply a page on the Companies Office website listing every licensed person under the following headings:

Unique identifier	Auditor's name	City/town	Licence status	Licensing authority	Kinds of audits

74 The proposed register will comply with the Public Register Privacy Principles in Part 7 of the Privacy Act 1993. The only personal information that will appear on the public register is the full name of each licensed insolvency practitioner and their unique identifier. Other personal information will be included in the register, but will not be publicly disclosed or, therefore, searchable by the public.

Consultation

Government agencies

75 Consistent with the attached RIS, the **Treasury** believes that co-regulation is not necessary at this time and considers Solution A outlined in paragraph 47 above to be preferable. Treasury considers that a more informed decision about the possible need for licensing can be better made as a part of the recommended post-implementation review of the effectiveness of any new regime.

76 The **Inland Revenue Department** supports the Solution A changes, particularly those that focus on increasing creditor rights and protections, based on both the economics and the fact that Inland Revenue is a creditor in many cases. Inland Revenue will review its requirements for liquidation services in light of decisions made.

77 The **Ministry of Justice** was consulted and has no comments on the paper.

78 The **Ministry of Foreign Affairs and Trade** was consulted on the New Zealand residency issue and the information it provided is reflected in paragraph 71.

79 The **Office of the Privacy Commissioner** was consulted on the establishment of a register of licensed insolvency practitioners.

80 The **Financial Markets Authority** was consulted on independent oversight. MBIE and the FMA agree that it would be appropriate for the Registrar of Companies to be responsible for independent oversight because it fits well with the Registrar's existing legislative responsibilities under the Companies Act. The FMA has no expertise in this area as insolvency is not within its current regulatory remit.

81 The **Department of the Prime Minister and the Cabinet** was informed.

The private sector

82 IWG Report No. 1 was released for public consultation for six weeks from late-August to early October. 30 submissions were received. There was strong support for licensing among the 26 submitters that made comments about that issue. 22 were in favour of co-regulation, two favoured government licensing and two opposed licensing in any form.

83 The New Zealand Bankers Association, CAANZ, RITANZ, and the great majority of insolvency practices and practitioners who submitted support the introduction of licensing.

84 Submitters who favour government licensing over co-regulation, or oppose licensing were concerned that RITANZ is dominated by large firms and could regulate in ways that would harm the interests of smaller practitioners.

85 There was general support for the measures proposed in Annex 1 of this paper, although some alternative views were expressed on a small number of proposals.

Financial Implications

86 I am proposing that licensed practitioners and the professional bodies will meet all of the costs of frontline regulation. This will not lead to significant additional costs for the 95 practitioners already accredited by RITANZ/CAANZ. However, up to 10 more practitioners would need to join the scheme and incur the costs of obtaining and maintaining accreditation.

87 Experience of independent oversight by the Financial Markets Authority under the Auditor Regulation Act 2011 suggests that independent oversight by the Registrar of Companies would cost $750,000 to $1 million a year. I propose that this amount be funded through the annual return fee for companies. This would amount to less than $2 per company a year.

88 There would be no need to increase the current annual return fee [redacted]

89 I also considered the possibility of funding independent oversight by way of a levy on insolvency practitioners. This option is infeasible because the annual levy would need to be about $7,500 to $10,000 per practitioner. It is very likely that a levy at these levels would cause serious harm by driving practitioners who take fewer appointments out of the market.

Human Rights

90 The only human rights issue arising from these proposals relates to compulsory membership of a professional body and its connection to freedom of association under the New Zealand Bill of Rights Act 1990.

91 This issue has been raised previously by the Exclusive Brethren Church, because their doctrines and beliefs preclude membership of any organisation or body other than their church. This issue can be managed by including a

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professional body membership exemption modelled on sections in the Financial Reporting Act 2013 that relate to the regulation of auditors.

Legislative Implications

92 The proposals in this paper can only be implemented by legislating. I am proposing to implement them by way of supplementary order paper to the Insolvency Practitioners Bill, which has been on hold since having a second reading in 2013.

93

94

Regulatory Impact Analysis

95 The MBIE Regulatory Impact Assessment Review Panel has reviewed the RIS prepared by MBIE and considers the information and analysis summarised in the RIS meets the quality assurance criteria.

Gender and disability

96 The proposals in this paper have no implications from gender or disability perspectives.

Publicity

97 I intend to proactively release this paper via the MBIE website, subject to deleting passages that relate to the Government's legislation programme and Budget 2017. I also intend to issue a press statement announcing the main decisions.

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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];

3 **Note** that it is essential for insolvency practitioners to act honestly, fairly and impartially at all times because they are placed in a position of managing and protecting other people's money and property;

4 **Note** that there are insolvency practitioners who fall well short of the expected standards of integrity and skill;

Companies Act and Receiverships Act improvements

5 **Note** that many but not all of the problems associated with the regulation of insolvency practitioners can be dealt with by implementing the following measures, which are detailed in Annex One of this paper:

5.1 Strengthening and modifying insolvency practitioner disqualifications;

5.2 Adding to and clarifying practitioners' responsibilities, roles and duties;

5.3 Changing practitioners' reporting requirements;

5.4 Providing the High Court with an efficient and effective power to disqualify and ban liquidators;

5.5 Prohibiting company directors and shareholders appointing liquidators and administrators from the date of service of a liquidation application by a creditor, other than with the applicant creditor's consent;

5.6 Avoiding the transfer of a company's assets to an associated party once a liquidation application has been filed, subject to certain exceptions; and

5.7 Only permitting related parties to vote at creditors' meetings if approved by the High Court;

6 **Note** that of the changes proposed in Annex One:

6.1 some were agreed to by Cabinet [CAB MIN (08) 31/5 and CAB MIN (11) 39/1 refer] and are included in the Insolvency Practitioners Bill, which was introduced in 2010, but has been on hold since 2013;

6.2 all but one of the remaining measures were recommended by the Insolvency Working Group;

6.3 the other measure was proposed by a submitter;

1mf850mx0s 2016-11-03 11:09:43

7 **Agree** to the changes described in Annex One;

8 **Authorise** the Minister of Commerce and Consumer Affairs to approve minor and technical changes to the Annex One measures;

9 **Note** that the Inland Revenue Department will review its requirements for liquidation services in light of decisions made;

Licensing insolvency practitioners

10 **Note** that the Recovery, Insolvency and Turnaround Association of New Zealand (RITANZ) and Chartered Accountants Australia and New Zealand (CAANZ) have been operating a voluntary Accredited Insolvency Practitioner system since January 2016;

11 **Note** that the introduction of occupational regulation under statute will:

11.1 provide additional ways of dealing with insolvency practitioner incompetence, dishonesty, debtor-friendliness; and

11.2 generally raise the standards of insolvency practice over time;

12 **Agree** to introduce co-regulation of insolvency practitioners, with the main functions being allocated as follows:

12.1 Professional bodies will be responsible for frontline regulation including issuing licences to practise, regulating ongoing requirements to retain a licence, investigating complaints, taking disciplinary action where appropriate and carrying out practice reviews;

12.2 The Registrar of Companies will be responsible for independent oversight, including:

12.2.1 accrediting professional bodies to be frontline regulators;

12.2.2 monitoring and reporting on the adequacy and effectiveness of each accredited professional body's regulatory systems and processes;

12.2.3 guarding against excessive regulation by being empowered to prevent the implementation of non-trivial changes to a licensing system by a professional body, on public interest grounds;

13 **Note** that RITANZ and CAANZ could become frontline regulators by making relatively minor changes to their voluntary Accredited Insolvency Practitioner system;

14 **Note** that RITANZ and CAANZ support the co-regulation proposals and are willing to be frontline regulators;

15 **Agree** the following in relation to the scope of the licensing regime:

15.1 Exclude compromises under Part 14 of the Companies Act 1993;

15.2 Include trustees appointed under the Insolvency Act 2006;

15.3 Limit solvent liquidations to lawyers and accountants who are members of a professional body, but do not include solvent liquidations within the scope of the licensing regime;

15.4 Exclude overseas-based practitioners, but provide the Registrar of Companies with powers to recognise practitioners from specific overseas jurisdictions;

15.5 Provide for exemption from the membership requirement for members of religious societies or orders whose doctrines or beliefs preclude such membership;

16 **Agree** that the Registrar of Companies will manage the register of licensed insolvency practitioners;

Funding co-regulation

17 **Agree** that professional bodies and their members will meet all costs of frontline regulation;

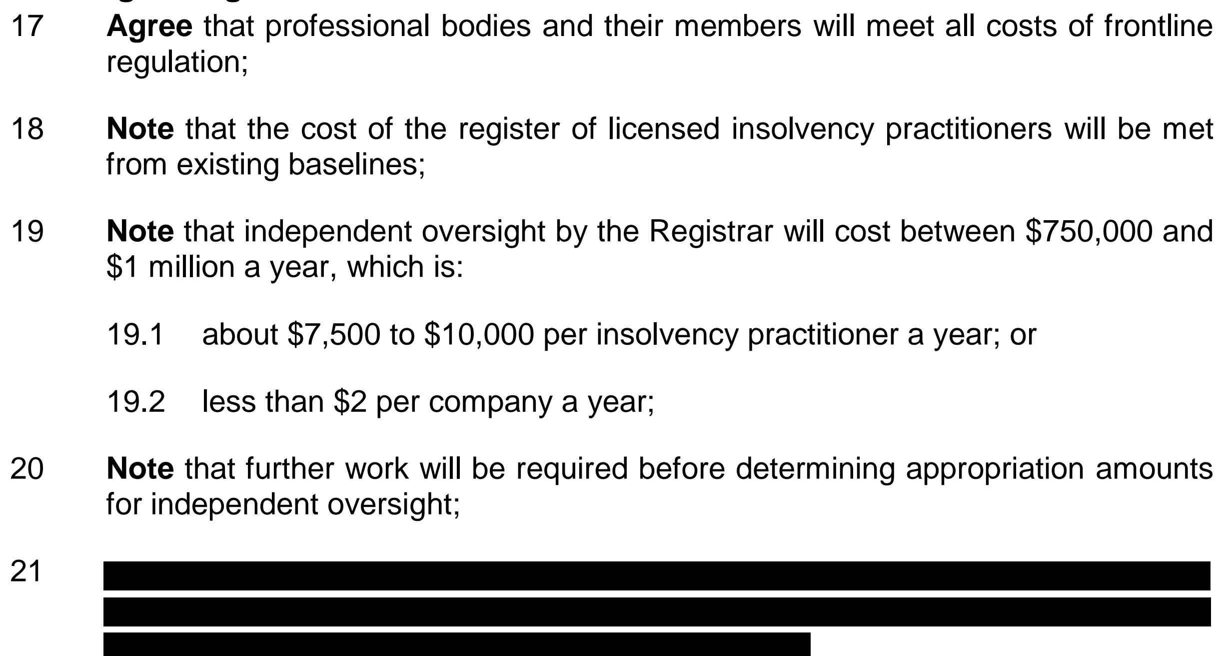
18 **Note** that the cost of the register of licensed insolvency practitioners will be met from existing baselines;

19 **Note** that independent oversight by the Registrar will cost between $750,000 and $1 million a year, which is:

19.1 about $7,500 to $10,000 per insolvency practitioner a year; or

19.2 less than $2 per company a year;

20 **Note** that further work will be required before determining appropriation amounts for independent oversight;

21 

Legislation

22 **Note** that:

22.1 The Insolvency Practitioner Bill was introduced in 2010 which proposed:

22.1.1 a negative licensing system that would have provided the Registrar of Companies with the statutory authority to prohibit an individual from providing corporate insolvency services [EGI Min (10) 7/4, paragraph 1 refers];

22.1.2 the strengthening of the automatic disqualification provisions;

22.2 The Commerce Committee reported the Bill back in 2011:

22.2.1 expressing concern that negative licensing did not go far enough;

1mf850mx0s 2016-11-03 11:09:43

22.2.2 proposed a registration system requiring a person to be registered (but not licensed) in order to be appointed as an insolvency practitioner;

22.2.3 included many of the improvements to the Companies Act 1993 and Receiverships Act 1993 described in Annex One of this paper;

22.3 The Insolvency Practitioners Bill has been on hold since it had a second reading in November 2013;

23 **Agree** that the changes agreed to above be implemented by Supplementary Order Paper to the Insolvency Practitioners Bill;

24 [redacted]

25 **Note** that the co-regulation provisions in the SOP could be modelled on the co-regulation regime contained in the Auditor Regulation Act 2011;

26 [redacted]

27 [redacted]

Post-implementation review

28 **Agree** that a post-implementation review be completed no less than three years after the legislative changes come into force;

Publicity

29 **Note** that the Minister of Commerce and Consumer Affairs will issue a press statement announcing these decisions; and

30 **Authorise** the Ministry of Business, Innovation and Employment to place this paper on its website, subject to deleting information about the 2017 Legislation Programme and Budget 2017.

Authorised for lodgement

Hon Paul Goldsmith
Minister of Commerce and Consumer Affairs

1mf850mx0s 2016-11-03 11:09:43

Annex One: Improvements to the Companies & Receiverships Acts

Table 1: Strengthen and modify insolvency practitioner disqualifications

No.	Description
1	Add the following offences to the lists of insolvency practitioner disqualifications: • Crimes of dishonesty as defined in the Crimes Act 1961; • Tax evasion and other serious offences under the Tax Administration Act 1994; and • Serious knowledge-based offences under other enactments. Add the following conflict-of-interest related disqualification criteria: • ensure that the general reference to 'creditor' includes secured creditor; • any persons who are or had been a director of a creditor company within the preceding two years before commencement of the liquidation; • any persons who had an interest in shares issued by the company or 5 per cent or more of any class of shares issued by a creditor of the company, within the preceding two years before commencement of the liquidation; • any persons who has an interest in 20 per cent or more of any class of shares issued by a related company of the company; • if there is an instrument conferring a power to appoint a receiver of a company, a person who is disqualified by the instrument from acting as the receiver of the company; and • persons (or their firms) who had a continuing business relationship with the company, or any of its directors or shareholders that have the power to appoint or remove a director of the company. Narrow the scope of two existing conflict-of-interest related disqualification criteria: • The continuing business relationship disqualification is too broad because it inappropriately includes a continuing business relationship with a secured creditor. In New Zealand, most financiers take a general security agreement as security for lending. This means that all insolvency practitioners who have worked for general security agreement financiers (e.g. trading banks) are unable to act as liquidators or administrators, unless the leave of the High Court is obtained. Making such applications is a waste of time and money. The reference to secured creditors should be removed. • The professional services relationship disqualification is too broad. This is because it excludes any practitioner where they or their firm have provided professional advice at the end of the company's trading life. This problem is especially acute for investigating accountants because they are also usually insolvency practitioners. This disqualification would be appropriately targeted if the wording was to be aligned with the definition of 'continuing professional relationship' in the Insolvency Engagement Standard issued by CAANZ.
2	In relation to the definition of 'relative', add a promoter or auditor of the grantor or a related company of the grantor. Add the following disqualification criteria: • If the grantor is a company, a person who has an interest, whether direct or indirect, in 20 per cent or more of any class of shares issued by a related company. • If the property in receivership is a company, a current or former administrator, deed administrator, or liquidator of the company.

1mf850mx0s 2016-11-03 11:09:43

No.	Description
3	The High Court is able to make a prohibition order under the Receiverships Act for a period not exceeding five years. There should be no time limit, as is the case under the Companies Act. Require the Registrar of Companies, rather than the Official Assignee to keep records of orders by the court.

Table 2: Additions and clarifications of practitioners' responsibilities, roles and duties

<table>
<tr><th>No.</th><th>Description of the change</th><th>Comments</th></tr>
<tr><td>4</td><td>• Require an administrator to transfer documents and property to a successor administrator.
• Create an offence where the administrator fails to do so.</td><td rowspan="2">Ensures an efficient transition and that the replacement administrator or liquidator has all the documents and control necessary to perform their functions.</td></tr>
<tr><td>5</td><td>• Require an administrator to provide to the liquidator of a company in administration documents, information and property.
• Create an offence where the administrator fails to do so.</td></tr>
<tr><td>6</td><td>Require a deed administrator:
• to certify that he or she is not disqualified from appointment; and
• table an interests statement at the watershed meeting.</td><td>Provides creditors information about the independence of the deed administrator.</td></tr>
<tr><td>7</td><td>• Require a deed administrator to transfer documents and property to a successor deed administrator.
• Create an offence where the administrator fails to do so.</td><td>Ensures an efficient transition and that the successor deed administrator has all the documents and control necessary to perform their functions.</td></tr>
<tr><td>8</td><td>• Add an offence for failure by the administrator to file accounts with the Registrar.</td><td>Promotes general deterrence.</td></tr>
<tr><td>9</td><td>• Clarify that a person to whom a prohibition order applies must not act as an administrator of a deed of company arrangement (DOCA).
• Clarify that the court may make an order in respect of a past or current deed administrator of a company under a DOCA.
• Clarify that the meaning of 'failure to comply' means failure to comply with an enactment, a rule of law, or court order, to the extent that it applies to the persons in their capacity as an insolvency practitioner.
• Require the Registrar (not the Official Assignee) to keep records of orders made by the court.</td><td>Technical amendments that improve the law.</td></tr>
</table>

1mf850mx0s 2016-11-03 11:09:43

No.	Description of the change	Comments
10	• Change the requirement on liquidators to hold accounts and records of the liquidation from one to six years, but retain the Registrar's discretion to vary the time period. • Include an offence provision for failure to comply.	Six years is consistent with the Limitation Act 2010 and the requirements under the Receiverships Act.
11	• Move, from regulations to the Companies Act, a requirement on a liquidator to deposit funds of a company under their administration at a bank and in either a bank account to the credit of the company or a trust account. • Permit a liquidator to invest money of a company that is not required for the time being to meet claims made against the company. • Require that all dividends, interest and other profits received from such investments be paid into the bank account or trust account. • Expressly state that funds which are deposited in a trust account must be held by the liquidator on trust for the benefit of the persons legally entitled to those funds. • Align the statutory provisions in relation to such trust accounts with the stricter rules in relevant professional codes of practice. • Create an offence when a liquidator fails to comply with duties in relation to company funds.	Adopts best practice in relation to handling money and technical amendments to improve the clarity of the law.
12	• Require a person vacating the office of liquidator to give written notice to the Registrar (instead of the Official Assignee). • If the office of liquidator is vacant, the Registrar (instead of the Official Assignee) may appoint another practitioner or an Official Assignee.	The Registrar is responsible for enforcing the Companies Act so it is appropriate for her to perform these functions.
13	• Move, from regulations to the Companies Act, the obligations relating to transferring documents and property to a replacement liquidator and add an offence.	Allows for an offence to be created.
14	• Add the Registrar to the list of those able to make an application for an order to enforce a liquidator's duties. • Require the Registrar, rather than the Official Assignee, to keep a record of orders by the High Court.	The Registrar is responsible for enforcing the Companies Act so it is appropriate for her to perform these functions.
15	• Set out what must be disclosed in an interests statement by liquidators, administrators and deed administrators, and the steps the person must take in preparing the interests statement. • Include a requirement that practitioners state how they intend to manage any conflict of interest.	Helps creditors make informed decisions about appointments.

1mf850mx0s 2016-11-03 11:09:43

No.	Description of the change	Comments
16	• Transfer restrictions relating to the remuneration of an insolvency practitioner from regulations to the Companies Act.	Allows for an offence to be created.
17	• Transfer restrictions on the purchase of assets, goods or services from a person connected to an insolvency practitioner from regulations to the Companies Act.	Allows for an offence to be created.
18	• Provide for documents and property to be given to the receiver's successor and create a new offence for failing to do so.	Ensures an efficient transition and that the replacement receiver has all the documents and control necessary to perform their functions.
19	• Create a new offence for a receiver failing to comply with their statutory duties in relation to money.	Provides a remedy where a receiver fails to comply with their statutory duties.
20	• Create a new offence for a receiver failing to comply with their statutory duties to keep correct accounting records.	
21	• Align the meaning of 'failure to comply' in the Receiverships Act with the definition in the Companies Act.	Ensures consistency.
22	• Improve the effectiveness of insolvency practitioners' whistleblowing duties in relation to serious offending by: o removing an irrelevant test relating to whether the offence was material to the insolvency process o expanding the range of statutes to which the obligation applies o expanding the list of enforcement agencies that can receive a report (e.g. the Police, SFO and other agencies, where relevant, e.g. Inland Revenue in relation to tax) o providing absolute privilege to administrators (as is already the case with liquidators and receivers).	Recognises that insolvency practitioners have wider responsibilities to society. The provisions should be consistent with the standard for professional accountants made by the International Ethics Standards Board for Accountants (IESBA) called *Responding to Non-compliance with Laws and Regulations* (NOCLAR), which comes into force in July 2017.
23	• Require liquidators and administrators to state in their notices of appointment who made the appointment or who applied for them to be appointed if they were appointed by the Court. • Require receivers to state in their notices of appointment the name of the appointing creditor, and information about the instrument under which the appointment was made. • Require deed administrators to give notice of appointment to the Registrar if he or she was not the administrator.	This information will be useful to creditors and improve transparency in relation to appointments.

Table 3: Changes relating to practitioners' reporting requirements

No.	Description of the change	Comments
24	• Require the administrator (at the end of an administration), and a deed administrator (on termination of a DOCA) to provide a summary report to the Registrar containing prescribed information. • Create an offence for failing to comply with this requirement.	This information would be used to collate data for statistical purposes, which will be useful for insolvency stakeholders and government agencies.
25	• Clarify that the liquidator must provide a statement of interests, report, and notices to every creditor for meetings of creditors.	Ensures that creditors obtain the information they need for decision-making and accountability purposes.
26	• Clarify that when a liquidator gives notice to creditors that a meeting will not be held, they must also give creditors a statement of interests, report, and notices to every creditor concerned.	
27	• Require the liquidator to send a statement of interests to every creditor, shareholder and the Registrar. • Require the liquidator's 6 monthly report be sent to every creditor and shareholder to include a statement of realisation and distribution that lists all amounts received and paid. Remove the requirement to list payers and payees. • Create an offence for a liquidator failing to comply with their reporting requirements.	Creditors obtain useful information for decision-making and accountability purposes. Reduces the 6 monthly reporting requirements to what is important i.e. the amounts distributed and how it was distributed between the different classes of creditors.
28	• Clarify that the final report sent to creditors and shareholders must list all amounts received and paid in respect of the liquidation, including payer and payee details. • Require the liquidator to provide a summary report of prescribed information to the Registrar. • Create an offence for the liquidator failing to comply with any duty in relation to the final report and accounts.	Ensures that creditors obtain the information they need for accountability purposes. Providing cumulative information increases the relevance of information because creditors will not need to refer back to previous reports and do their own calculations.
29	• Clarify what must be contained in the receiver's 6 month report and the final report.	Consistent with changes to improve reporting by liquidators to enhance transparency and accountability to creditors.
30	• Provide summary report at the end of a receivership to the Registrar. • Create an offence for not doing so.	

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Table 4: Provide the High Court with an effective power to disqualify and ban liquidators

No.	The problem	The proposed change
31	There are powers for various parties to seek an order from the High Court to (a) enforce a liquidator's duties, (b) remove a liquidator from office, or (c) make a prohibition order against a liquidator for a specified or indefinite period. The existing powers have never been successfully used because the process is convoluted and time-consuming. The existence of a 'two-strike rule' means that it can take multiple hearings over several months before the Court can make an effective order.	Empower the court to make a disqualification or banning order for one bad action (e.g. theft) under a fast and efficient system.

Table 5: Prohibit company directors and shareholders from appointing a liquidator or administrator from the date of service of a liquidation

No.	The problem	The proposed change
32	Shareholders or directors can voluntarily appoint a liquidator up to 10 working days after service on the company of a liquidation application by a creditor. This provides them with the opportunity to appoint a debtor-friendly, incompetent or dishonest liquidator.	Expand the limitation, so that a company will be prevented from voluntarily entering into liquidation or administration from the date of service of a liquidation application by a creditor. Some submitters suggested that this change should not be made on the grounds that it unreasonably restricts debtors' ability to exercise their legitimate rights. I disagree for three reasons: • The insolvent company will have had plenty time prior to the service of the notice to appoint a liquidator or administrator on its own volition. • Making this change will provide an incentive for debtors to act earlier. This will usually benefit the company's creditors as a whole as more of the assets of the company will remain. • It will substantially reduce the scope for debtor-friendly liquidators to be appointed.

Table 6: Avoid the transfer of a company's assets to an associated party after service of a liquidation application, subject to certain exceptions

No.	The problem	The proposed change
33	There is no restriction on the transfer of a company's assets once a liquidation application has been filed.	Any transfer of assets outside the ordinary course of business would be rendered void after service of the application to liquidate. The onus would then shift to the transferee to prove a basis on which it should retain the assets. If not, the liquidator would be able to recover the asset.

1mf850mx0s 2016-11-03 11:09:43

No.	The problem	The proposed change
	This is a problem because the liquidation application is often the signal for a rapid transfer of assets, often at undervalue or at no value, by shareholders and directors prior to the appointment of a liquidator.	The provision would have some limits: • It should not apply to transfers by a receiver or administrator (or by the liquidator after being appointed). • The Court would have an ability to allow a transfer. • The liquidator should have the ability, once appointed, to ratify the transfer. A transfer of assets would give rise to a breach of duty claim against the directors, should the assets be transferred to an associated party.

Table 7: Only permit related parties to vote at creditors' meetings if approved by the High Court

No.	The problem	The proposed change
34	Related parties may vote unless the Court orders otherwise. This situation can lead to outcomes that are contrary to the collective interests of shareholders because related parties often have a conflict of interest.	Reverse the situation, so that related parties must obtain a court order to be able to vote.

1mf850mx0s 2016-11-03 11:09:43