Review of
Corporate Insolvency Law

Report No. 2 of the Insolvency Working Group, on voidable transactions, Ponzi schemes and other corporate insolvency matters

May 2017

ABOUT THIS REPORT

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About the Insolvency Working Group

Background

The Insolvency Working Group (IWG) is a panel of experts set up by the Government in November 2015 to examine aspects of corporate insolvency law and provide independent advice.

The first of our two reports (Report No. 1) was finalised in July 2016. It covered two of the four matters in the terms of reference (see **Annex 1)**: the regulation of insolvency practitioners and voluntary liquidations including phoenix companies.

This is our second and final report (Report No. 2). It addresses the two other topics we have been asked to report on: voidable transactions and Ponzi schemes.

We were also asked to consider whether there are other potential areas of corporate insolvency law reform. We have identified a number of issues and make recommendations on them in **Annex 2**.

Members

- *Graeme Mitchell* (Chair) is a former Deloitte Audit and Assurance Partner. He currently serves as the Chair of the External Reporting Board, and as a Director of Barnados New Zealand.

- *Crispin Vinnell* is an expert in insolvency and recovery matters and a Partner at law firm Anthony Harper.

- *David Young* is the Executive Director of Debtworks (NZ) Limited and has extensive debt collection and credit management experience.

- *John Fisk* is Wellington Managing Partner at PricewaterhouseCoopers with more than 25 years' experience specialising in business recovery services.

- *Michael Arthur* is an experienced commercial litigator and a Partner at law firm Chapman Tripp.

- *Vivian Fatupaito* is a Director at KPMG where she leads the firm's liquidation practice.

- *Guy Caro* is a Senior Solicitor at the Ministry of Business, Innovation and Employment, and represents the Official Assignee.

Disclosure by John Fisk

John Fisk disclosed that he is the first respondent and cross-appellant in *McIntosh v Fisk*. This Supreme Court case relates to a Ponzi scheme, Ross Asset Management (RAM). The central issues in the case relate to whether certain payments made by RAM to Mr McIntosh before Mr Fisk was appointed as liquidator are voidable transactions.

The other members of the IWG agreed that this was not a conflict of interest and it would be appropriate for Mr Fisk to fully participate in the consideration of the voidable transactions regime and the links between insolvency law and Ponzi schemes. We reached this conclusion because there was no possibility that our consideration of these topics could have any impact on the outcome of *McIntosh v Fisk*. The terms of reference for the IWG did not ask for advice on possible retrospective law changes and nor did we consider giving any such advice.

Executive summary

E1. This report addresses two main issues: voidable transactions, and the application of insolvency law to Ponzi schemes. We also discuss several other corporate insolvency law issues. To ensure that consistency is maintained between corporate and personal insolvency law, we also recommend that some of our recommended changes to the Companies Act 1993 should also be made to the Insolvency Act 2006.

Voidable transactions

Background

E2. The *pari passu* principle of insolvency law states that creditors of the same class should be treated equally. In support of this objective, the Companies Act provides that certain transactions entered into and charges given by a company prior to it being placed in liquidation are voidable. This means that a liquidator may be able to compel an individual creditor to pay back an amount that they received before the debtor company was placed in liquidation if the debtor company was insolvent at the time the payment was made, the payment took place no more than two years before the liquidation was commenced, and the creditor obtained more than they would have received under the distribution rules in the Companies Act.

E3. There is, however, a competing societal interest: to provide certainty to businesses that they can rely on the validity of payments. The retrospective nature of the voidable transactions regime is largely inconsistent with this societal interest.

E4. The main challenge is to balance the need to protect the collective interests of all creditors with the need to provide commercial certainty to individual creditors who have received payments in good faith. This is not an easy trade-off to make. As a result, voidable transactions law is controversial and will remain controversial.

The *Allied Concrete* decision

E5. The current voidable transactions regime in the Companies Act was enacted in 2006 and came into force in 2007. The aim of those reforms was to resolve policy and interpretation difficulties associated with the previous regime. Those expectations have not been met. Some of the new and replacement provisions have also proven to be difficult to interpret.

E6. There have been several court cases since 2007. Some decisions provided clarity about specific provisions in the voidable transactions regime. However, it was not until the Supreme Court issued its decision in the *Allied Concrete* case[1] in 2015 that the purpose of the 2006-7 reforms and specific provisions were clarified.

E7. The key finding related to the creditor's defence in section 296(3). It states that a court must not order the recovery of property from a preferred creditor if the creditor is able to prove three things. Two of the requirements relate to the creditor's moral conduct. The third is an either/or test: to prove that the creditor 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.

E8. A consequence of the Supreme Court's decision is that the 'gave value' test, which was added in 2006, will always be satisfied in voidable transactions cases because creditors will always have provided some consideration that has a real and substantial value. Thus, the alternative 'altered position' test is largely irrelevant. Only the two creditor moral conduct tests remain.

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[1] *Allied Concrete Limited v Meltzer* [2015] NZSC 7, (2015) 10 NZBLC 99-717, (2015) 13 TCLR 833.

Our views on the law as clarified in *Allied Concrete*

E9. *Allied Concrete* has shifted the voidable transactions regime towards the interests of individual creditors. We have mixed views about this. On the positive side, the increased certainty for creditors that they will not be required to repay preferred payments is to be welcomed. Individual creditors' interests were not adequately protected under the regime as it was understood and applied before the Supreme Court clarified the law. On the other hand, the focus of the defence on the creditor's moral conduct means that the voidable transactions regime is not effects-based. This is inconsistent with the policy aim that the equal treatment principle should underpin the voidable transactions regime.

E10. *Allied Concrete* has also had the effect of increasing administration costs because liquidators and creditors now routinely need to enquire into the creditor's conduct. They may need to make use of discovery procedures, carry out a detailed study of large numbers of documents and cross-examine witnesses in order to resolve a voidable transaction claim. Consequently, there are fewer insolvent transaction recoveries. The potential for incurring high administration costs impacts on a liquidator's decision about whether to start a claw back process. Thus, considerably less weighting is given to the collective interests of creditors than might be apparent by reading *Allied Concrete*.

E11. In our view, the combined effect of the direct and indirect impacts of *Allied Concrete* is that the collective interests of creditors are not adequately protected. Changes are needed to better recognise the equal treatment principle. However, it is also essential to ensure that preferred creditors continue to have considerably more commercial certainty than they had prior to *Allied Concrete*.

Major recommendations relating to voidable transactions and other recoveries

E12. We are proposing two main changes in Chapter 1. First, the 'gave value' part of the test in the creditor's defence should be repealed. This change would increase the protection provided to creditors as a whole by reinstating the 'altered position' test.

E13. Second, the period of vulnerability for voidable transaction clawbacks should be reduced from 2 years to 6 months prior to the commencement of the liquidation where the debtor company and creditor are not related parties. We consider that this reduction would provide reasonable levels of business certainty for individual creditors without unduly harming the collective interests of creditors.

E14. We emphasise that these two recommendations need to be considered together. We do not recommend repealing the 'gave value' part of the defence without also reducing the time limit. The collective interests of creditors will be promoted by requiring preferences to be returned or repaid most of the time if they occurred within the six month period of vulnerability. The interests of individual creditors will be promoted by ensuring that preferences more than six months earlier cannot be challenged if the debtor and creditor were unrelated parties.

Other proposals relating to voidable transactions and other recoveries

E15. In Chapters 2 and 3, we propose several other improvements to the provisions relating to voidable transactions and other recoveries. These changes are independent of the recommendations in Chapter 1. They include:

- standardising the clawback period for voidable transactions and all other classes of recovery (e.g. transactions at undervalue) at four years where the debtor company and the preferred creditor are related parties;

- reducing the limitation period from six to three years for voidable transactions and the other statutory rights of recovery under sections 292 to 299;

- providing the High Court with the discretion to extend the filing period where it would be just and equitable to do so;
- simplifying the continuing business relationship test by removing the subjective elements relating to the parties' intentions; and
- adding a defence for a creditor with a valid security interest who can demonstrate that there was no preference at the time they received payment.

Ponzi schemes

E16. A **Ponzi scheme** is a fraudulent investment operation where the operator provides returns to investors from new capital paid to the operators by new investors, rather than from profit earned by the operator. Ponzi schemes are unsustainable and insolvency is inevitably the outcome, often with substantial investor losses arising.

E17. Although insolvency law was never intended or designed to address fraud, and nor should it be, liquidators do have some means to recover whatever funds remain on behalf of investors:

- A liquidator can take action against an investor who received a preferred payment prior to the scheme's collapse under the voidable transactions regime, or the prejudicial dispositions regime under sections 344 to 350 of the Property Law Act 2007. The extent to which the regime can be used for this purpose was addressed in the High Court and Court of Appeal in *Fisk v McIntosh*. The Supreme Court has heard an appeal and cross-appeal against the Court of Appeal's majority decision but is yet to issue a decision.
- A liquidator may take action against the owner or operator to seek restitution for knowing receipt of funds in breach of trust, dishonest assistance to a trustee to disperse trust funds in breach of trust and, possibly, unjust enrichment.

E18. In addition, investors may seek recovery of their investments from the assets held by the liquidator of the scheme through proprietary tracing claims. The Crown may take action against the owner or operator under the forfeiture provisions under the Criminal Proceeds (Recovery) Act 2009.

E19. In Chapter 4, we consider potential ways that insolvency law and the Property Law Act might better protect the interests of investors in Ponzi schemes and to speed up recovery processes. However, we do not make any recommendations in this regard. Whether there is any need for change cannot be adequately addressed until after the Supreme Court releases its decision in *McIntosh v Fisk*.

Other issues

E20. The Terms of Reference also asked us to provide advice on any other corporate insolvency issues that could be addressed. In Chapter 5 we recommend two types of changes. First, several changes aimed at improving the efficiency and effectiveness of corporate insolvency law. Many are technical changes designed to clarify provisions. This will reduce the cost to insolvent estates in debating or litigating points that are currently unclear.

E21. The other changes recommended in Chapter 5 are designed to alter allocations of funds in insolvencies by achieving a fairer allocation of resources:

- To introduce a new preferential claim for gift cards and vouchers, ranking equally with an existing preference for lay-by sales. The need for this change was highlighted by the collapse of Dick Smith Electronics shortly after Christmas 2015. The change would mean that gift card and voucher holders are less likely to be out-of-pocket because they would rank higher than ordinary unsecured creditors.

- To limit the existing preferential claims for taxes and customs and excise duties to six months from the date the debt falls due. Imposing a time limit means that Inland Revenue and New Zealand Customs Service would become ordinary unsecured creditors in relation to older debts. This change will better protect the interests of other ordinary unsecured creditors because it will incentivise IRD and Customs to intervene earlier where it is evident that a company cannot be rehabilitated.

- To provide that recoveries from reckless trading claims are not to be distributed to secured creditors. This change will better protect unsecured creditors, including preferential creditors, where directors of the debtor company (or interests associated with them) hold a general security agreement and the directors continue trading long after the company ought to have been liquidated.

E22 We did not undertake a broader review of the restructuring options available in Parts 14, 15 and 15A of the Companies Act. We are not aware of any major issues with those systems and there is no evidence that wholesale changes are needed. Nevertheless, it is important to ensure that those systems provide workable and cost effective means for viable businesses that are financially distressed to be restructured.

E23. We consider that it would be useful for the New Zealand Government to continue to monitor overseas developments. In particular, the Australian Government is in the process of implementing two specific reforms that are aimed at improving its voluntary administration regime. It would be useful for the Government to consider the possible suitability of those changes to New Zealand once the details are known.

E24. Chapter 6 identifies which of our recommendations also impact on personal insolvency law and should, therefore, also be made to the Insolvency Act 2006.

Recommendations

Chapter 1 – Voidable transactions: Balancing the interests of the body of creditors and individual creditors

R1. Repeal the ‘gave value’ part of the test in section 296(3)(c) of the creditor’s defence, restoring the defence to one that operates only where a creditor, in good faith and without suspicion of insolvency, relies on the payment itself.

R2. Reduce the period of vulnerability for insolvent transactions (section 292) from two years to six months where the debtor company and the preferred creditor are unrelated parties.

Chapter 2 – Other issues relating to voidable transactions and other recoveries

R3. Retain the two year period of vulnerability for clawbacks for unrelated party transactions at undervalue.

R4. Standardise the period of vulnerability for all clawbacks under sections 292, 293, 297 and 298 at four years where the debtor company and the preferred creditor are related parties.

R5. Use the definitions of ‘related creditor’ and ‘related entity’ that appear in section 245A (and section 239AM) of the Companies Act for determining whether a party is a related party in relation to all recoverable transactions, charges and securities.

R6. Retain the presumption of insolvency in relation to transactions and charges in the six months prior to the commencement of a liquidation.

R7. Reduce the deadline for liquidators to file in the High Court claims under sections 292 to 299 from six to three years.

R8. Provide the High Court with the discretion to extend the filing period under sections 292 to 299 if it would be just and equitable to do so.

R9. Add a defence for a creditor with a valid security interest who can demonstrate that there was no preference at the time they received payment.

R10. Simplify the continuing business relationship rule in section 292(4B) of the Companies Act by removing the subjective element relating to the parties’ intentions.

R11. Clarify that the starting point for a continuing business relationship is the start of the specified period or the point of the debtor’s insolvency, whichever is later.

Chapter 3 – Procedural issues relating to voidable transactions

R12. Amend section 294, relating to the content and form of a liquidator’s notice for setting aside transactions, by replacing the current list within section 294 itself, with a power to prescribe the content and form by Order in Council.

R13. Prescribe the following content under the Order in Council:

a) all matters currently prescribed by section 294(2) of the Companies Act 1993;

b) standard information about the transaction or charge to be voided, including:
   i. the date of the transaction;
   ii. the nature of the consideration;

iii. the dollar value;
iv. the parties to the transaction; and
v. where there is a continuing business relationship, the date and dollar value of all transactions forming part of the relationship as if they constituted a single transaction; and

c) basic information about the voidable transactions regime that will be helpful to creditors who are unfamiliar with the regime, including:
   i. the essential criteria for setting aside any transaction or charge;
   ii. the rules under the creditor's defence; and
   iii. the benefits of obtaining legal advice.

R14. Provide that the clawback period commences from the date of appointment of the voluntary administrator if the creditors decide to appoint a liquidator at the watershed meeting.

R15. Clarify that the recoveries under sections 292, 293 and 297 to 299 should be paid out in the order specified under Schedule 7 of the Companies Act.

Chapter 4 – Ponzi schemes

R16. After the Supreme Court releases its decision in *McIntosh v Fisk*, the Government should assess whether there is any need to make the following changes:

a) Aid the recovery of funds under the Property Law Act 2007 by adding a Ponzi presumption and/or a good faith defence; and

b) The establishment of a compensation scheme.

Chapter 5 – Other corporate law insolvency issues

Companies Act 1993

R17. Amend, for the purposes of Part 16 (Liquidation), the definition of 'secured creditor' to include all creditors holding a security interest as defined in the Personal Property Securities Act 1999.

R18. Provide that recoveries from reckless trading claims are not available to secured creditors but instead are distributed only to unsecured creditors (including preferential creditors).

R19. Require all administrators' reports to be filed with the Registrar of Companies.

R20. Provide powers to liquidators to obtain certain information from third parties without needing to apply to the courts.

R21. Align the meaning of 'telecommunications services' in the Companies Act and the Receiverships Act 1993 with the meaning of 'telecommunications service' in the Telecommunications Act 2001.

R22. Provide that fines and penalties are admissible claims in liquidation, but are subordinate to claims by unsecured creditors.

R23. Allow communication by electronic means between the liquidator and creditors.

Preferential claims under Schedule 7 of the Companies Act 1993

R24. Clarify whether long service leave forms part of the preferential claim for employees.

R25. Establish a new preferential claim for gift cards and vouchers, with the same ranking as layby purchases.

R26. Place a six month limit on the preferential claims for amounts unpaid to the Commissioner of Inland Revenue and the Collector of Customs.

R27. Amend section 167 of the Tax Administration Act 1994, such that all claims for PAYE provable in a liquidation are to be paid in accordance with Schedule 7 of the Companies Act 1993.

Receiverships Act 1993

R28. Clarify that the priority for administrators' fees and expenses continues to apply when a company is both in receivership and administration.

R29. Align the priority in section 30(2) in respect of the assignment of accounts receivable with section 153(2)(b) of the Property Law Act 2007.

Statistical data

R30. The Registrar of Companies should collate and publish information from reports lodged by insolvency practitioners.

Chapter 6 – Changes to the Insolvency Act 2006

R31. Make changes equivalent to recommendations 1-13, 15, 17 and 24-27 to the Insolvency Act 2006.

Chapter 1: Voidable transactions

Background

1. Sections 292-296 of the Companies Act 1993 state that certain transactions entered into and charges[2] given by a company prior to it being placed in liquidation are voidable. Sections 297-301 relate to other types of recoveries that are also available to liquidators. Sections 292-301 are reproduced in **Annex 3**. Various statutory tests must be met before determining whether a transaction or charge is voidable and, if so, whether it shall be set aside. If a transaction is set aside, the liquidator may apply to the High Court for an order requiring the creditor to repay the amount received, transfer the property to the liquidator or pay an amount that fairly represents some or all of the benefits the person received.[3]

2. This section of Report No. 2 relates mainly to voidable transactions and charges. However, there are broader implications because section 296(3) contains a creditor defence that also applies to other recovery-related provisions in the Companies Act (e.g. transactions at undervalue), recoveries under other enactments, and recoveries in law and in equity.

3. The fact that a liquidator can compel a creditor who has received an otherwise lawful payment to pay it back makes voidable transactions a controversial and sometimes emotive topic. It can be particularly unpopular where the main or sole effect of setting aside a preference to an unsecured creditor is to provide additional funds to meet the liquidator's fees and disbursements, or pay preferred creditors (e.g. the Commissioner of Inland Revenue) more than they would otherwise have received.

4. There have been two significant sets of amendments to the legislative provisions during the last 25 years. Despite that, there has been uncertainty about the meaning of some of the key provisions. It has often been left to the Supreme Court and Court of Appeal to provide greater certainty in appeal cases subsequent to different High Court judges interpreting the law in different ways at different times. A short history of the legislative provisions dating back to the law as it was before the enactment of the Companies Act 1993 through to the present is set out in **Annex 4**.

The legal context for voidable transactions

5. The voidable transactions system fits within a wider regime for reversing transactions and charges. That wider regime has the following main elements:

   A. rules for determining whether a transaction is voidable;

   B. rules for determining whether a charge is voidable;

   C. the process for setting aside a voidable transaction or charge;

   D. the availability of recovery in other cases; and

   E. a defence for the recipient of the money or property to resist actions taken by a liquidator to make recoveries.

6. A-C relate only to voidable transactions. D relates to other recoveries that can be made under the Companies Act.[4] E relates to the full range of recoveries that can be made under the Companies Act, other legislation, law and equity. Each element is summarised below.

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[2] Legal charges arise from agreements that give lenders an interest over a borrower's assets.
[3] Companies Act, s 295.
[4] Companies Act, ss 297-299. These provisions relate to transactions at undervalue, transactions with directors and certain other persons for inadequate or excessive consideration, and certain securities and charges in favour of directors and certain other persons.

A. The main rules for determining whether a transaction is voidable

7. The following matters need to be considered in order to determine whether a transaction is voidable:

   I. Was the transaction an insolvent transaction?

   II. If so, was the insolvent transaction entered into during the 'specified period'?

8. Depending on the circumstances, it can also be necessary to determine:

   III. Whether the transaction was an integral part of a 'continuing business relationship'.

I: Was the transaction an insolvent transaction?

9. The Act states that a transaction is insolvent if:

   - it is entered into at a time when the company is unable to pay its due debts; and
   - it enables another person (i.e. a creditor of the company) to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.[5]

II: Was the insolvent transaction entered into during the specified period?

10. The next step is to determine whether an insolvent transaction was entered into within the 'specified period'.[6] That period starts two years before the date of the commencement of the liquidation.[7] There is also a presumption, unless the contrary is proved, that the debtor company was insolvent if the transaction was entered into no more than six months before the commencement of the liquidation.[8] This period is called the 'restricted period'.

11. The combined effect is that:

    - the onus of proof is on the creditor to demonstrate that the debtor company was solvent at the time if the transaction occurred within the restricted six month period; and
    - the onus of proof is on the liquidator to demonstrate that the debtor company was insolvent at the time if the transaction occurred within the specified two year period but not within the restricted six month period.

III: Was the transaction an integral part of a continuing business relationship?

12. Ordinarily, the operation of section 292(1)-(3) renders every insolvent transaction, in principle, recoverable by the liquidator. Individual payments are aggregated to form the amount eventually to be sought to be returned to the general pool for distribution. However, this straightforward calculation of preferences is altered in the case of a 'continuing business relationship.[9] Section 292(4B) provides that all transactions between a creditor and a liquidated company should be treated as a single transaction where:

    - an individual transaction is, for commercial purposes, an integral part of a continuing business relationship; and
    - in the course of the relationship, the level of the liquidated company's indebtedness to the creditor has increased or reduced from time to time as the result of the series of transactions.

[5] Companies Act, s 292(1)(a), (2) & (3). There is a definition of 'transaction' in s 292(3). We do not discuss this definition because we are not aware of any problems with it.
[6] Companies Act, s 292(1)(b).
[7] Companies Act, s 292(5).
[8] Companies Act, s 292(4A) & (6).
[9] *Timberworld Limited v Levin* [2015] NZCA 111 at [29].

13. If those criteria are met, then all of the transactions are treated as a single transaction. Rather than being able to potentially set aside all of the individual payments made by the liquidated company, the liquidator may instead only set aside the net reduction in indebtedness across the course of the continuing business relationship.

14. Australian case law has allowed liquidators to select the point of maximum (or peak) indebtedness as the starting point of the continuing business relationship. This means that the voidable transaction is as large as possible. This is not the situation in New Zealand. In *Timberworld Limited v Levin*,[10] the Court of Appeal stated that the peak indebtedness rule was not part of New Zealand law. It found that the appropriate starting point is the beginning of the specified period.

B. The rules for determining whether a charge is voidable

15. The voidable transactions regime also applies to charges over any property or undertaking of a company.[11] A charge will be voidable if it was given within two years and the company was unable to pay its due debts immediately after it was given. There are three exceptions:

- where the charge is given in substitution for an earlier security;
- where the charge secures money advanced, value of property supplied or other valuable consideration given in good faith at the time or after the charge is executed; or
- in the case of a charge securing the purchase price of property, where the charge is signed within 30 days of the sale of the property.

C. The process for setting aside a voidable transaction or charge

16. A liquidator who considers that a transaction or charge is voidable may seek to have it set aside.[12] In order to do so, the liquidator must file a notice containing prescribed information[13] with the court, and serve the notice on the other party, who has the opportunity to object. The transaction or charge is automatically set aside if such objection is not received by the liquidator within 20 working days.[14] The court also has powers to set aside a transaction or charge that is not automatically set aside on application by the liquidator.[15]

17. The maximum period for enforcement action by a liquidator is six years from the commencement of the liquidation. This is the standard period for money claim-related civil proceedings under section 11 of the Limitation Act 2010.

D. The availability of recovery under the Companies Act in other cases

18. In addition to voidable transactions and charges, the Companies Act includes powers for a liquidator to seek to recover or set aside the following types of transactions and charges:

- transactions at undervalue, within the same two year period specified for voidable transactions;[16]
- transactions for inadequate or excessive consideration with directors or certain other persons, within a specified period of three years;[17] and

[10] [2015] NZCA 111.
[11] Companies Act, s 293.
[12] A liquidator has six years from the time the company goes into liquidation to bring a voidable transactions claim. See section 11(1) of the Limitation Act 2010.
[13] Companies Act, s 294. We recommend adding further classes of prescribed information in Chapter 3 of this report – see Recommendation 13.
[14] Companies Act, s 294(3)-(4).
[15] Companies Act, s 294(5).
[16] Companies Act, s 297.
[17] Companies Act, s 298.

- securities or charges created in favour of a director of the company or certain other persons. There is no specified period.[18]

19. A related provision empowers the court to require persons to repay money or return property.[19] It is merely procedural. It does not create any causes of action.

E. The recipient's defence

20. Section 296(3) of the Companies Act provides a defence for the recipient of the money or property to resist actions taken by a liquidator to make recoveries. Other than applying to voidable transactions and other transactions under the Companies Act, the defence also applies to the recovery of property under any other enactment (but not the Land Transfer Act 1952), or in law or equity.

21. To successfully invoke the defence the recipient must prove, when they received the property that:

    a) they acted in good faith;

    b) a reasonable person in their position would not have suspected, or they did not suspect or have reasonable grounds to suspect that the debtor was or would become insolvent; and

    c) they (i) gave value for the property, or (ii) altered their position in the reasonably held belief that the transfer of property was valid and would not be set aside.

22. The good faith rule in subsection (a) is assessed subjectively and involves an inquiry into the honesty of the creditor. In order to establish good faith the recipient must demonstrate that they did not suspect insolvency, and show an honest belief that the transaction would not give them or any guarantor a preference and took no steps to secure or protect their position.[20]

23. Subsection (b) requires an objective inquiry into the circumstances that existed at the time of the transaction. It takes into account the actual information and knowledge available to that particular recipient.

24. We discuss subsection (c) below in considerably more detail because it has a major impact on the effectiveness of the entire voidable transactions regime.

The gave value or altered position rule under section 296(3)(c)

25. When enacted in 1993, the defence did not include the 'gave value for the property' test. It was added in 2006 and became law in 2007. There have been a number of High Court and Court of Appeal decisions relating to this test since 2007. However, the scope of the defence was not settled until 2015 by the Supreme Court's ruling in *Allied Concrete*.[21]

26. This decision hinged on whether 'value' means new value given at, or after, the time the payment is received from the company, or whether it also includes value given prior to the receipt of the payment, including when the antecedent debt was created.

The Court of Appeal's decision in Allied Concrete

27. The Court of Appeal had held that the receipt of a payment in satisfaction of an antecedent debt was not 'value' and a new value which was also "real and substantial" must be given. It also considered that the word 'when' as used in the phrase 'when [the creditor] received the property' indicated that a temporal restriction was intended. The recipient had to give value at or after the time the payment was made. Value given by the provision of goods and services at an earlier point when the debt was created did not qualify.

[18] Companies Act, s 299.
[19] Companies Act, s 301.
[20] *Levin v Market Square Trust* [2007] NZCA 135, [2007] 3 NZLR 591 at [54].
[21] *Allied Concrete v Meltzer* [2015] NZSC 7, (2015) 10 NZBLKC 99-717, (2015) 13 TCLR 833.

28. This decision was overturned by the Supreme Court.

The Supreme Court's ruling in Allied Concrete

29. The Supreme Court considered two competing policy aims in assessing why Parliament decided to add the 'gave value' rule:

- to protect an insolvent company's creditors as a whole against a diminution of the assets available to them resulting from a transaction which confers an inappropriate advantage on one creditor by allowing that creditor to recover more than they would have otherwise obtained; and

- to provide protection to an individual creditor in some circumstances. This protection acknowledges that there are risks to commercial confidence if transactions that appear to be normal are re-opened long after the event.[22]

30. In balancing these aims, the Supreme Court noted that a policy decision was made to align New Zealand's position with that of Australia.[23] On this basis it was unanimously concluded that Parliament's purpose in adding the 'gave value' test in 2006 was to provide creditors with more certainty that the transactions they are entering into will not be made void.[24] The Supreme Court held that, given Parliament's purpose, 'value' can include value given when the debt was initially incurred by the debtor company as a result of an earlier transaction, provided the value was real or substantial. A creditor does not have to provide new value.[25]

31. The Supreme Court also held that 'when', which appears earlier in section 296(3), merely meant that there had to be linkage or connection between the impugned payment and the elements of section 296(3).[26] This means that a creditor will be taken to have provided value in satisfaction of section 296(3)(c) regardless of whether value was provided before, at the time of, or after the voidable payment.

The impact of the Supreme Court's ruling

32. Under the law as interpreted prior to the Supreme Court's decision, it was very difficult for a preferred creditor to meet the requirements of the 'gave value' test. Consequently, the creditor almost always needed to meet the alternative requirement in subsection (c), i.e. to prove that they had altered their position in the reasonably held belief that the transfer of the property was valid and would not be set aside.

33. Under the law as clarified by the Supreme Court, the 'gave value' element is almost always satisfied in insolvent transactions cases because a creditor almost always provides real or substantial value merely by providing goods or services to the company. Certainly, any ordinary trade creditor will always have provided value. The ease of meeting the 'gave value' test means that the alternative 'altered position' test in subsection (c) is almost irrelevant. A creditor only has to prove that they met the good faith and reasonable person tests in subsections (a) and (b).

34. Consequently, the scope of the defence is much broader than the defence as it had been previously understood by insolvency practitioners and lawyers. This amounts to a significant shift in the balance towards the interests of the individual creditors who received payments. The result was, arguably, to return the regime to one in which unremarkable transactions were immune. Prior to the 2007 reforms, in which the "gave value" defence was introduced, transactions which were in "the ordinary course of business" could not be set aside.

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[22] *Allied Concrete* at [1(a) & (b)].
[23] *Allied Concrete* at [77].
[24] *Allied Concrete* at [101].
[25] *Allied Concrete* at [105].
[26] *Allied Concrete* at [66].

Public reaction to the Supreme Court's decision

35. The response to the Supreme Court's decision in *Allied Concrete* was largely positive. For example, posts by Kensington Swan and Russell McVeagh on their websites commented favourably on the commercial certainty benefits for individual creditors, but did not include any opinions about the impact on the collective interests of creditors.

36. Kensington Swan stated that:

> Today's decision by the Supreme Court concludes a period of uncertainty for liquidators and creditors, and will be particularly welcomed by creditors who now have greater certainty that the transactions they are entering into will not be made void up to two years down the track. The decision will be keenly received by those in the construction industry, who regularly supply goods and services on account. Also, one-off trade creditors, who were not previously able to rely on the defence as the only 'value' given by these creditors is at the time of supply of goods or services, can now rely on the defence against a liquidator's action.[27]

37. Russell McVeagh stated that:

> The decision brings welcome certainty for those providing services on credit with no security (e.g. subcontractors in the construction industry)… In circumstances where creditors provided value for their payment, a payment to a creditor will not be voidable where the creditor both acted in good faith and had no reasonable grounds to suspect insolvency. We expect that greater focus will now be placed on whether creditors suspected, or ought to have suspected insolvency at the time of payment and whether substantial value was given by the creditor.[28]

38. Duncan Cotterill acknowledged the advantages of increased commercial certainty for individual creditors and the disadvantages for the body of creditors:

> Trade creditors will have a lot more certainty about their commercial transactions following the Supreme Court's unanimous decision... While some may feel that the choice of the individual over the whole offends against strict adherence to the concept of collective realisation, others may feel that this decision results in a more just outcome – with only those who knew or should have known that the debtor company had liquidity issues required to divest themselves of the debtor company's property for the good of trade creditors as a whole.[29]

39. Fortune Manning Lawyers were more sympathetic to the collective interests of creditors. They noted that:

> The decision has been lauded by many commentators as a victory for small business, traders, contractors and the like. This fails to take into account the effect on the pools of creditors looking for a recovery of sums unpaid by a company in liquidation. The liquidator's duties are to ensure that the concept of equal distribution (or *pari passu*) occurs to the greatest extent possible.[30]

Objectives

40. We discuss the following matters:

- the principles of corporate insolvency law;
- the rationale for voidable transactions;

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[27] Kensington Swan Lawyers, *Supreme Court decision on 'value' welcomed by creditors*,18 February 2015, https://www.kensingtonswan.com/Legal-Updates-And-Events/Construction/2015/Supreme-Court-decision-on-value-welcomed-by-cred.aspx.

[28] Russell McVeagh, *Restructuring and Insolvency Update*, 18 February 2015, http://www.russellmcveagh.com/Publications/ViewPublication/tabid/176/Title/valuable-judgment-for-those-extending-credit-liquidators-lose-in-the-supreme/pid/365/Default.aspx.

[29] Dale Nicholson and Darise Barrington, *Bringing certainty to voidables*, LawTalk 860, 13 March 2015, p.26.

[30] Fortune Manning Lawyers, *Supreme Court Decision Clarifies Voidable Transaction Defence*, March 2015, http://www.fortunemanning.co.nz/Publications/Dispute+Resolution/Supreme+Court+Decision+Clarifies+Voidable+Transaction+Defence.html.

- commercial certainty; and
- administrative and compliance efficiency.

The principles of corporate insolvency law

41. The two main principles of insolvency law are equal sharing between creditors (also called the *pari passu* principle) and having an orderly process immediately preceding and during the formal insolvency administration.[31] These principles are interdependent: equal sharing distribution requires that all creditors be seen as one entity.[32]

42. Equal sharing requires the liquidator of an insolvent company to distribute the available assets of the company among each class of the general body of creditors in proportion to their admitted claims. If, for example, there are sufficient assets to pay 20 percent of the total amount owed to unsecured creditors after paying all other prior ranking creditors in full, then each individual ordinary unsecured creditor will be paid 20 cents in the dollar, as determined at the date of liquidation.

The rationale for voidable transactions

43. Three rationales have been developed for having voidable transactions regimes: equal sharing, debtor deterrence and creditor deterrence.[33]

Equal sharing

44. Most companies that are liquidated for insolvency reasons become insolvent well before a liquidator is appointed. In order to protect the collective interests of creditors, the equal sharing principle applies from the point of insolvency, not liquidation. The only matters to enquire into are whether a transaction was entered into or a charge was given at the time the debtor was insolvent, and if so, whether the creditor obtained more than they would have under the equal sharing principle. Preserving and protecting the equality of distribution is the prevailing reason for having a voidable transactions regime. It is the rationale that we apply.

Debtor deterrence

45. The debtor deterrence rationale started developing under English case law in the 16th Century but fell out of favour in common law jurisdictions in the 19th and 20th Centuries. It was based on the idea that preferring a creditor amounts to fraud by the debtor on all other creditors. The emphasis was on the debtor's state of mind and the reprehensibility of the debtor's conduct. The debtor deterrence approach underpinned the voidable transactions regime in the Companies Act 1955. This approach is no longer used because the debtor's intention to prefer one creditor as a basis for setting aside transactions is at odds with the objective of achieving equality between creditors.

Creditor deterrence

46. The creditor deterrence rationale is based on what would be likely to happen if there were no insolvency laws. It posits that once individual creditors learn about a debtor's insolvency, there would be a free-for-all where creditors would be involved in a race to the courts to pursue their rights against the debtor company and enforce the resulting court decisions. Thus, the focus is on the creditor's state of mind when receiving a preference. This approach is also at odds with the objective of achieving equality between creditors.

Commercial certainty

47. It is also essential to acknowledge that the retrospective nature of voiding a transaction is contrary to the societal interest of providing certainty to a business that it can rely on the

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[31] Other insolvency law objectives (e.g. providing a fresh start) have not been included because they have little if any bearing on voidable transactions policy.

[32] Anthony Duggan and Thomas G.W. Telfer, *Canadian Preference Law Reform,* Texas International Journal of Law, (2007) 42:661 at 670; and Kurt Hyzler, *The Principle of Pari Passu in Corporate Insolvency*, LLD thesis, University of London, May 2006 at p.15. https://www.gvzh.com.mt/app/uploads/2016/04/The-Principle-of-Pari-Passu-in-Corporate-Insolvency-by-Kurt-Hyzler.pdf.

[33] ibid, Duggan and Telfer, pp 662-667.

validity of a payment. Being required to repay an amount to a liquidator does not merely return the preferred creditor to the position they would otherwise have been in. It can usually be expected that the creditor would have made different decisions had they not received the preference in the first place. By obtaining the preference, the creditor's cash flow position will have been improved and that will almost always affect numerous subsequent business decisions. For example, a preferred creditor may have relied on the improved cash flow to pay its own creditors.

48. The Law Commission highlighted this trade-off in 1989 when recommending a new voidable transactions regime to replace the regime in the Companies Act 1955:

> As can be seen, the emphasis is on the effect of the transfer. Any system which creates a regime rendering some transactions void has to choose between competing interests. In this case, <u>some measure of commercial certainty is sacrificed in favour of fairness to all creditors</u>[34] (our emphasis).

49. In applying this trade-off, the Law Commission recommended a maximum clawback period of one year.[35] The rule that was included in the Companies Act 1993 was two years.

50. The Supreme Court made comments to similar effect in *Allied Concrete*. For example it stated that:

- the voidable preference provisions are not concerned with achieving fairness as between the creditor and the company, but rather fairness between the creditor and other similar creditors;[36]

- equal sharing and fairness to individual creditors are important but potentially conflicting policies;[37] and

- there is a need for balance between the interests of the pool of creditors on insolvency and the needs of commerce in permitting transactions in the normal course of business.[38]

51. We agree with the statements made by the Law Commission and the Supreme Court.

Administrative and compliance efficiency

52. Voidable transaction regimes can be difficult to apply in practice. It can, for example, be difficult to determine whether a creditor's position has been improved as a result of receiving one or more payments while the debtor company was insolvent. The need for potentially complex and time-consuming enquiries raises two potential concerns:

- **Administrative inefficiency** for the liquidator. Those costs are met indirectly by one or more creditors because excessive administration reduces the size of the pool of funds available for distribution to creditors.

- **Excessive compliance costs** for the creditor in responding to the liquidator's requests for information and, in some cases, challenging the liquidator's findings. This includes concerns that normal business activity may be impeded if time that would otherwise be spent on managing the creditor's business is instead absorbed by attending to a voidable transactions matter.

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[34] Law Commission, Report No. 9, *Company Law Reform and Restatement*, June 1989, paragraph 696.
[35] ibid, Draft Companies Act, see ss 225(1)(a)(iii) and 227(1), pp. 317-8.
[36] *Allied Concrete* at [95].
[37] *Allied Concrete* at [1].
[38] *Allied Concrete,* concurring separate judgment of Elias CJ at [174].

Conclusions on objectives

53. To summarise, we assess the voidable transactions regime against the following objectives:

    A. **Consistency with the equal sharing principle**, which is achieved when creditors of the same class are treated equally in relation to insolvent transactions that pre-date the commencement of the liquidation.

    B. **Fairness to individual creditors**, which is achieved when there is business certainty and a preferred creditor's interests are not materially harmed if they are required to pay or repay money or return property.

    C. **Administrative and compliance efficiency**, which is achieved when the following costs are minimised as far as possible:

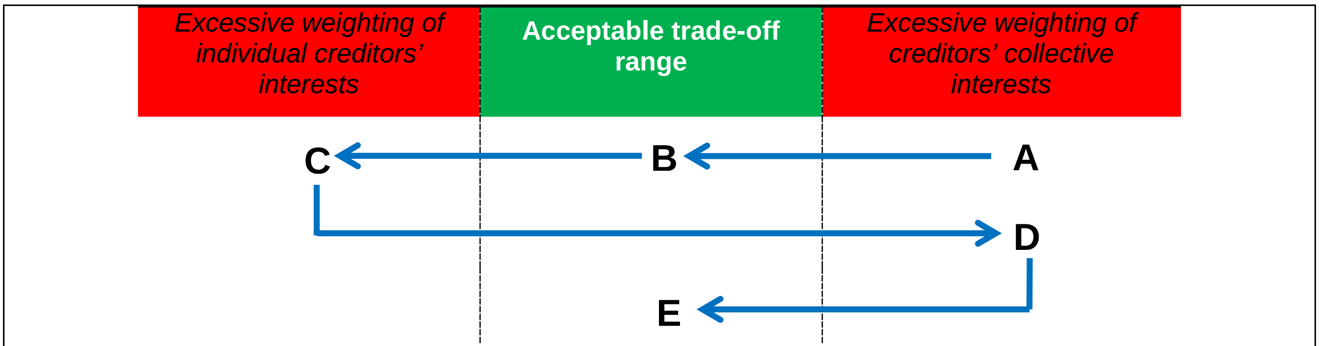
    - costs associated with the processes for a liquidator to take possession of, protect and realise, and distribute the assets or the proceeds of the realisation of the assets of the company to its creditors;[39] and

    - compliance costs for creditors against whom claims are made.

Problems and solutions

54. Figure 1 summarises the remainder of our discussion on the voidable transactions regime through to our conclusions and recommendations at the end of Chapter 1. It illustrates the main problem with the regime as it was understood before the Supreme Court clarified the law in 2015 in *Allied* Concrete (A), the problems with the current regime (B and C), an option we do not recommend (D), and our recommended option (E).

Figure 1: Problems and solutions



A The law as it was understood prior to the Supreme Court's decision in *Allied Concrete*

B The apparent status quo (i.e. *Allied Concrete* without considering the impact of excessive administration and compliance costs)

C The status quo in practice (i.e. *Allied Concrete* after also considering the impact of excessive administration and compliance costs)

D Option – Repeal the 'gave value' test within s 296(3)(c) alone – **not recommended**

E Option – Repeal the 'gave value' test and reduce the period of vulnerability for clawbacks from two years to six months – **recommended**

[39] This description of administrative efficiency appears in subsection (a) of s 253 of the Companies Act, which describes the principal duty of a liquidator.

55. In addition, our report recommends a number of changes in Chapter 2 and 3 that will achieve a fairer allocation of resources and improve the efficiency and effectiveness of corporate insolvency law.

Problems with the voidable transactions regime

56. The main issue is whether the voidable transactions regime appropriately balances the objectives referred to above. We consider that there are two main problems:

- the collective interests of creditors are not adequately protected because they cannot be considered under the creditor's defence; and
- individual creditors who are not related to the debtor company are subject to excessive business uncertainty due to the two year period of vulnerability for clawing back voidable transactions and charges and other recoveries.

Problem One: Inadequate weighting of creditors' collective interests

57. The law as it was understood and applied prior to the Supreme Court's decision in *Allied Concrete* gave too much weighting to the collective interests of creditors (**point A in Figure 1**). This was due to difficulties preferred creditors had in proving that they had altered their position in the reasonably held belief that the transfer of the property was valid and would not be set aside, particularly in relation to older transactions under the two year vulnerability rule.

58. The clarification provided by the Supreme Court in *Allied Concrete* has produced important commercial certainty benefits for unsecured creditors (**point B in Figure 1**). However, we have concerns about the way that the balance is achieved in practice for the following reasons:

- it is commercially inefficient in that it incentivises creditors to know as little as possible about a debtor's position and its ability to pay debts;
- claims against ordinary trade creditors now primarily depend on whether the creditor knew of the debtor company's financial position. This is at odds with the rejection of the 'creditor deterrence' theory inherent in the design of the effects-based regime in the 1993 Act; and
- the need to investigate creditors' knowledge results in higher administration costs for liquidators and can increase compliance costs for individual creditors.

Commercial inefficiency

59. Under *Allied Concrete*, a creditor is taken to have provided value in satisfaction of section 296(3)(c) regardless of whether the value was provided before, at the time of, or after the voidable payment. This element will almost invariably be satisfied in voidable transactions cases because creditors will always have provided some consideration that has a real and substantial value.

60. In effect, a creditor only has to meet the requirements of subsections (a) and (b), i.e. to prove that they were honest and did not have reasonable grounds for suspecting insolvency. There is no need for the creditor to prove that they altered their position in the reasonably held belief that the transfer of property was valid and would not be set aside. This is commercially inefficient because it punishes diligent creditors and rewards inactive creditors. Put another way, it incentivises companies to not actively monitor their debtor companies.

Inconsistent with effects-based test

61. Section 292 concerns recoveries from creditors who were lawfully entitled to receive the payments made to them. New Zealand's voidable transaction law has never been based on the 'creditor deterrence' policy rationale described earlier in this report. The 1993 reforms were instead expressly based on seeking to uphold equal sharing. We do not see any moral imperative to disincentivise creditors from pressing for payment. In our view, the law is not

well designed if knowledge on the part of the creditor is the key determinant of liability, when knowledge of the debtor's financial position (on the part of the creditor) is not something the commercial community considers to be wrong, or wishes to discourage.

62. In short, the Supreme Court's decision elevates knowledge of insolvency to a fundamental question in every voidable transaction claim, but such knowledge is not, in our view, relevant to the underlying policy for the regime.

Excessive administration and compliance costs

63. Prior to the law being clarified by the Supreme Court, it was unusual for liquidators to have to inquire into the creditor's intent because of the need for the creditor to prove that they altered their position in the reasonably held belief that the transfer of the property was valid and would not be set aside. The effect of the clarification is that the alternative effects-based 'altered position' test within section 296(3)(c) is largely redundant and all that remains are the two creditor-intent based tests set out in subsections (a) and (b). Hence, intent needs to be considered in almost every case.

64. Liquidators will not start claw back processes unless they anticipate that there are reasonable prospects of building a persuasive case to underpin a satisfactory out-of-court settlement. This is not a problem in itself. However, since 2015 liquidators have needed to carry out more detailed study of large numbers of documents. In addition, we anticipate that liquidators will more frequently need to cross-examine the creditor and make more use of discovery procedures. It also means that recipients of notices from liquidators will usually need to invest considerably more time and effort in order to develop their best case against the liquidator's claim. The creditor may also endure a longer period of uncertainty about the outcome.

65. This outcome is inconsistent with the objective of minimising administration and compliance costs as identified in paragraph 53.

66. It is also inconsistent with the equal treatment objective because the administration costs associated with enquiring into the creditor's state of mind means that liquidators are considerably less likely to pursue preferences. An expert commentator noted in November 2015 that "there will be far fewer insolvent transactions recoveries".[40] In our experience, that is exactly what has happened.[41] In practice, the collective interests of creditors are given much less weighting under the voidable transactions regime in the Companies Act than was expressly acknowledged in *Allied Concrete*.

67. Although it is inevitable that expected administration costs will impact on a liquidator's decision about whether to investigate and pursue a preferred payment, administration costs now often predominate. For this reason we consider that the 'actual' post-*Allied Concrete* position (**point C in Figure 1**) gives excessive weighting to the interests of individual creditors.

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[40] Mike Whale, *A Commentary on Allied Concrete Limited v Meltzer and Hayward, and Grant and Khov v BB2 Holdings Limited,* Auckland District Law Society (CPD, Voidable Preferences: Developments and Consequences), 26 November 2015, p.2.

[41] It is very difficult to quantify the reduction because most voidable transactions claims are settled out of court and are not recorded on a register. Hence, the number of court judgments on voidable transactions under s 292 is not necessarily a good proxy for total numbers. However, we note that 11 judgments from 9 proceedings dealing substantively with voidable transactions under s 292 were issued in 2016, including two at appellate level. In summary:

- liquidators obtained a recovery on five occasions, three of which constituted partial recovery;
- liquidators were denied recovery in two cases, one because the other party was not a creditor; and
- two cases were applications for discovery.

Problem Two: Excessive business uncertainty

The two year clawback period

68. In New Zealand, a transaction or a charge is voidable if it occurred no more than two years before the liquidation was commenced.[42] This rule is very different from the rules in other jurisdictions (see **Annex 5**, which outlines the periods of vulnerability in Australia, the United Kingdom, Canada and the United States) for the following reasons:

- the time limit in New Zealand is the same for all voidable preferences. It is usual to have much shorter periods in other jurisdictions if the debtor company and the preferred creditor are unrelated parties; and
- New Zealand has both an effects-based test and a relatively long period of vulnerability. It is more usual overseas to have a long clawback period only if the liquidator is required to prove that the debtor company intended to prefer the recipient.

69. The two year rule in New Zealand places a very strong emphasis on the collective interests of creditors. By contrast, the need for commercial certainty dictates that the period of vulnerability should be relatively short. The risks to commercial confidence under the current law are significant because businesses can be exposed to a very large amount of trading over the course of any two year period. As the Supreme Court noted, it can be particularly harsh if what appears to be a normal, everyday commercial transaction is re-opened long after the event.[43]

Options

70. We consider that the only feasible options are to retain the status quo or implement the following package of changes:

- repeal the 'gave value' test within section 296(3)(c) of the creditor's defence; and
- substantially reduce the period of vulnerability for creditors who are unrelated to the liquidated company.

71. We prefer the change option for the reasons discussed below.

Discussion

72. The two creditor moral conduct limbs of the creditor's defence should be retained, but the 'gave value' test in the third limb should be repealed. This change would require a creditor to meet the alternative test in the third limb, i.e. to prove that they altered their position in the reasonably held belief that the transfer of the property was valid and would not be set aside. It would largely return the substance of the creditor's defence to where it was between 2007 and 2015, i.e. the manner in which it was being applied before the Supreme Court clarified the law.

73. That is, the test will return to one that applied only where a creditor had no suspicion of insolvency and had, in good faith, relied on the payment itself. Similar tests are found in other parts of the law. It is quite usual that a recipient of funds should not be required to repay those funds where the recipient honestly and without notice relied on the validity of the receipt and changed their position in reliance on that.[44]

74. This change will have two main advantages. First, it would re-establish an effects-based test and, therefore, provide for creditors' collective interests to be considered. Second, it would reduce administration costs for liquidators and, therefore, allow for the outcome of preferential payment issues to be considered more on their merits rather than being driven

[42] Companies Act, ss 292(5) & 293(6). A transaction is not voidable if it occurred within the 2 years, but the debtor company was solvent at the time.
[43] *Allied Concrete* at [2(b)].
[44] See, for example, Judicature Act 1908, s 94B.

by cost factors.

75. However, making this change alone would be unsatisfactory because it would reverse the commercial certainty benefits obtained from *Allied Concrete* and place excessive weighting on creditors' collective interests (**point D in Figure 1**). We consider that the interests of creditors are better protected by reducing time limits. We consider that a six month period of vulnerability would provide appropriate levels of commercial certainty for unrelated party creditors without causing undue harm to the interests of the body of creditors.

Conclusions

76. We consider that the following changes would provide an appropriate balance between the collective interests of creditors and the interests of individual creditors (**point E in Figure 1**):

- reinstate the 'altered position' test to the creditors' defence by repealing the 'gave value' test within section 296(3)(c); and
- reduce the period of vulnerability for clawbacks from unrelated parties from two years to six months.

77. We consider that these changes would balance the objectives in paragraph 53 for the following reasons:

- liquidators would regain the ability to protect the collective interests of creditors;
- individual creditors would obtain appropriate levels of commercial certainty through stricter time limits, not for administrative cost reasons; and
- total administration and compliance costs would be proportionate.

Recommendations – Chapter 1

R1. Repeal the 'gave value' part of the test in section 296(3)(c) of the creditor's defence, restoring the defence to one that operates only where a creditor, in good faith and without suspicion of insolvency, relies on the payment itself.

R2. Reduce the period of vulnerability for insolvent transactions (section 292) from two years to six months where the debtor company and the preferred creditor are unrelated parties.

Chapter 2: Other issues relating to voidable transactions and other recoveries

78. In this chapter we discuss issues relating to:
    A. the period of vulnerability for related party voidable transactions;
    B. the period of vulnerability for other transactions and charges;
    C. the definition of 'related party';
    D. the onus of proof;
    E. the limitation period;
    F. the treatment of creditors with valid security at the time a payment was received;
    G. the continuing business relationship rule; and
    H. the starting point for determining whether a transaction should be set aside.

79. The recommendations arising from the discussion of these matters are independent of the two recommendations made in Chapter 1. The changes we recommend in Chapter 2 should be made with or without the Chapter 1 changes.

A. The period of vulnerability for related party voidable transactions

80. As with unrelated parties, a transaction or charge is voidable for related parties if it occurred no more than two years before the liquidation was commenced.[45] The definition of 'related party' is discussed in paragraphs 91-94.

81. We do not support reducing the period of vulnerability to six months for related party transactions because the creditor fairness issues discussed in Chapter 1 do not usually arise. When companies get into financial difficulty, the owners know about it before other parties. The directors of the debtor company can take advantage of this knowledge to harm the interests of unrelated party creditors. In addition, related party creditors are more likely than other creditors to have information that puts them on notice of the company's financial situation.

82. We consider that the period of vulnerability should be longer than two years in relation to related party transactions and charges. Directors have a significant degree of control over the date of commencement of the liquidation. Two years provides too much scope for directors to manage the liquidation commencement date to avoid clawbacks from a related party. We consider that extending the period of vulnerability to four years would adequately manage this risk because it is unusual for a company to be insolvent that far back.

83. We also consider that the increased administrative and compliance costs associated with four years are justified, given the mischief often associated with related party transactions and charges when a company is insolvent or may be moving towards insolvency.

B. The period of vulnerability for other transactions and charges

84. The rules in relation to recoverable transactions or charges other than voidable transactions and charges are:

    I. two years of vulnerability for transactions at undervalue;[46]

    II. three years of vulnerability for certain transactions with related parties for inadequate consideration (if the debtor company is the seller) and excessive consideration (if the debtor company is the buyer);[47] and

[45] Companies Act, ss 292(5) & 293(6).
[46] Companies Act s 297(3)(b).
[47] Companies Act s 298(4).

III. no time restriction in relation to securities and charges created by the company in favour of a related party that can be set aside by the High Court.[48]

I. Transactions at undervalue

85. Section 297 provides for the liquidator to recover the difference between the market value of a transaction and the consideration paid by the debtor company where the former amount exceeds the latter.

86. Unlike voidable transactions, transactions at undervalue are not normal everyday transactions. They often amount to a misuse of limited liability, particularly where they trigger the company's insolvency, and they always harm the collective interests of creditors. We consider that:

- the period of vulnerability should continue to be two years for unrelated party transactions at undervalue; and
- the period of vulnerability should be increased to four years for related party transactions at undervalue.

II. Transactions for inadequate or excessive consideration

87. Section 298 relates to:

- acquiring a business, property or services from a related party for excessive consideration; and
- disposing a business, property or services, or issuing shares to a related party for inadequate consideration.

88. Section 298 provides for the liquidator to recover the difference between the market value and the consideration paid or received by the debtor company. However, this provision only applies to related party transactions.

89. We consider that the period of vulnerability should be standardised for all related party transactions because the same issue arises in relation to all of them: the need to protect against directors managing the liquidation commencement date to defeat the interests of the body of creditors. Therefore, we recommend that the period of vulnerability be increased from three to four years for transactions covered by section 298.

III. Securities and charges in favour of other related parties

90. Section 299 states that the court may make such orders to set aside a security or charge created over a company's property or undertaking in favour of a related party. There is no specified period. We are not aware of any existing or potential problems in relation to the absence of a time limit under this provision. Hence, we do not recommend any changes in this regard.

C. The definition of related party

91. It is essential for the Companies Act to include a definition of related party so that company directors and creditors understand which transactions, charges and securities are at risk of being voidable for up four years, rather than six months.[49]

92. Section 245A includes definitions of 'related creditor' and 'related entity' (see **Annex 6**) that are used for providing the court with powers to order remedies where voting by related parties has changed the outcome of a vote at a meeting of creditors.[50] The definition of

[48] Companies Act, s 299.
[49] Assuming our recommendation to reduce the period of vulnerability from two years to six months for unrelated parties is accepted.
[50] The same definition appears in s 239AM(3), which relates to votes cast at creditors' meetings of companies in voluntary administration.

'related entity' includes a range of parties who have or may have a conflict of interest (e.g. a spouse, a close relative, or a company with at least one director who is also a director of the company in liquidation).

93. The definitions under section 245A are also fit for the voidable transactions-related purpose because the objective is the same: to ensure that creditors with a conflict of interest are unable to harm the interests of other creditors.

94. The definitions of 'related party' in sections 298(1) & (2) and 299(1) have a purpose similar to the definition in section 245A. However, the definitions in section 245A provide a more comprehensive list of persons. We consider that the additional parties covered by section 245A can also have a conflict of interest in relation to the transactions, charges and securities that can be recovered under sections 298 and 299. We recommend, therefore, that the definitions in section 245A also be used for the purposes of sections 298 and 299.

D. The onus of proof

95. As noted in paragraph 11, there are presumptions in sections 292 and 293 of the Companies Act that the company:

- was insolvent in the six month 'restricted period' prior to the commencement of the liquidation; and
- was not insolvent prior to the six month period.

96. We are recommending no changes in this regard. This will mean that the onus of proof:

- will continue to be on the creditor to demonstrate solvency in relation to all transactions and charges subject to claims under sections 292 and 293, and which occurred within the six month 'restricted period' (under our main recommendation such claims against non-related parties would all be within this period);
- will be on the liquidator in relation to:
    - o transactions and charges subject to claims under sections 292 and 293, and which occurred prior to the six month 'restricted period' (under our main recommendation such claims could only be made against related parties); and
    - o all transactions and charges covered by sections 297, 298 and 299.

E. The limitation period

97. Six years is the standard limitation period for money claims under section 11 of the Limitation Act 2010. This means that liquidators have six years from the date of the liquidation to bring a claim under the voidable transactions and other recoveries provisions.[51] At present this means that a liquidator has as much as eight years to bring a claim if the transaction or charge took place at the beginning of the current two year period of vulnerability. Although it would fall to 6½ years under our current proposals, that is still a considerable amount of time. In addition it would, under our proposals, increase to 10 years in relation to related party transactions, charges and securities.

98. The Legislation Advisory Committee states that strong policy reasons particular to the circumstances of legislation must be present to justify a departure from the standard time limits for civil proceedings in the Limitation Act.[52] We consider that there are strong policy reasons for a much shorter period than the standard six years for money claims in relation to voidable transaction clawback claims. We recommend reducing the time limit for the liquidator to file clawback claims from six to three years for the following reasons:

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[51] We exclude s 301 in this context, it being a purely procedural section that allows liquidators to bring claims based on rights outside of ss 292 to 300.

[52] Legislation Advisory Committee, *Guidelines on Process and Content of Legislation*, October 2014, p.93.

a) in accepting payment, an unrelated party creditor has not behaved in a manner that could in any way be regarded as blameworthy;

b) it would address concerns about excessive business uncertainty for the creditor and evidential difficulties for both parties in relation to older transactions. The two time-related changes we propose would reduce the maximum to 3½ years for unrelated party transactions and charges;

c) it would provide further balance in relation to the increased risks for individual creditors in connection with repealing the 'gave value' test; and

d) it would support the requirement within the principal duty of a liquidator to carry out the liquidation in a reasonable and efficient manner.[53] In the normal course of events, three years is sufficient time for liquidators to gather the information they need to decide whether a claim should be brought and to file a claim.

99. We also consider that the court should be given discretion to extend the time limit on application by the liquidator. It would not be appropriate for the court to routinely grant extensions, as appears to be the law in Australia following a court case in 2015.[54] We consider that the liquidator should be required to at least identify the counterparty or transaction under scrutiny in applying for an extension. We also consider that the court should only grant an extension if it would be just and equitable to do so. For example, a court might decide to grant an extension if there was evidence that a director or the creditor had obstructed the liquidator from obtaining information.

100. We also considered the option of a two year limitation period. However, we concluded that this would be too short because preferred creditors have incentives to delay the process. It is likely that liquidators would be forced to seek an extension from the courts too frequently.

F. Creditors with valid securities at the time payment was received

101. A transaction is insolvent if it is (a) entered into at a time when the company is unable to pay its debts, and (b) enables the creditor to receive more towards satisfaction of the debt than they would have received (or been likely to have received) in the company's liquidation.[55]

102. In *Levin v Market Square Trust,* the Court of Appeal considered whether the test of whether a creditor has been preferred is to compare the amount received with the amount the creditor would have received in a hypothetical liquidation on the date of the payment, or in the actual liquidation. The Court stated that the latter applies.[56]

103. This approach is appropriate in most circumstances. However, we have a concern about it as it relates to a creditor who had a valid security at the time payment was received (e.g. a perfected purchase money security interest under the Personal Property Securities Act 1999). We consider that it is unfair on the creditor that their valid security interest will have been negated simply because the assets over which the security was held were subsequently traded away.

104. Although the point of insolvency is the usual rule for voidable transactions, the hypothetical liquidation rule should apply in relation to valid securities.[57] We consider that a defence should be added in relation to a creditor with a valid security interest who can demonstrate that there was no preference at the time the payment was made.

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[53] Companies Act, s.253.
[54] *Grant Samuel Corporate Finance Pty Ltd v Fletcher (as liquidators of Octaviar Ltd (res and mgrs. Apptd) (in liqu) and Octaviar Adminstration Pty Ltd (in liq) and Others* (2015) 106 ACSR).
[55] Companies Act, s 292(2).
[56] See note 20 at [44-45].
[57] The rationale for using the hypothetical liquidation is explained in *Principles of Insolvency Law*, Professor Sir Roy Goode, QC, 4th edition (2011), paragraph 13-92, p.584.

G. The continuing business relationship rule

Background

105. Section 292(4B), which was enacted in 2006 and came into force in 2007, introduced the concept of a 'continuing business relationship' into New Zealand law from Australia. It states that a transaction between a debtor company and a creditor prior to the commencement of the liquidation must be netted off against other transactions between the parties if:

    a) the transaction is, for commercial purposes, an integral part of a continuing business relationship between the debtor company and a creditor; and

    b) in the course of the relationship, the level of the company's net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship.

106. The 'single transaction' is then assessed as to whether it is an insolvent transaction that is voidable by the liquidator.

Comment

107. The continuing business relationship replaced an 'ordinary course of business' test which had proved to be highly uncertain and involved subjective, intention-based considerations. However, the continuing business relationship test is also uncertain. Whether a transaction is, "for commercial purposes, an integral part of a continuing business relationship" often requires the liquidator to make difficult judgments about the degree of continuation intended by the parties during the relationship. It can be particularly complex for the liquidator to deduce intent if there were changes in the pattern of supply over time.

108. In addition, the continuing business relationship rule does not always lead to outcomes that are consistent with the equal treatment principle. For example, Supplier A may supply $10,000 worth of goods every month during the six months prior to liquidation and be paid $10,000 after each supply. Supplier B may supply and be paid for a one-off shipment of goods for $60,000 within the six months. Even though there is no difference in substance, there is a difference in the outcome. Supplier A will obtain the benefits of the continuing business relationship rule, but Supplier B will not.

109. We consider that it is essential to retain a continuing business relationship rule because it is consistent with the equal treatment principle. However, the benefit is largely achieved merely by netting off supplies and payments between the debtor company and the creditor. The additional requirement under the current test to enquire into the parties' intentions creates considerable complexity without commensurate additional benefit. We conclude, therefore, that the continuing business relationship test should only involve the simple process of netting out the debits and credits without the need for any enquiry into the parties' intentions.

110. This change will, on occasions, mean that individual creditors are lucky or unlucky as a result of receipt and payment timing issues. However, we consider that this disadvantage is clearly outweighed by:

    - the reduction in administration costs for liquidators and compliance costs for creditors; and

    - increased business certainty for creditors as a result of having certainty about the net amount that may be voided.

H. The starting point under the continuing business relationship rule

111. The Companies Act does not specify the commencement date for a continuing business relationship. This has created unnecessary uncertainty.

112. The Court of Appeal decided in the *Timberworld* case[58] that the starting point is the commencement of the specified period. This starting point makes sense in situations where the debtor company was unable to pay its due debts through the entire specified period. However, the courts have not ruled on the starting point if the insolvency occurred within the specified period. From an equal sharing perspective, it is clear that the starting point should be the start of the specified period or the point of the debtor's insolvency, whichever is later.

Recommendations – Chapter 2

R3. Retain the two year period of vulnerability for clawbacks for unrelated party transactions at undervalue.

R4. Standardise the period of vulnerability for all clawbacks under sections 292, 293, 297 and 298 at four years where the debtor company and the preferred creditor are related parties.

R5. Use the definitions of 'related creditor' and 'related entity' that appear in section 245A (and section 239AM) of the Companies Act for determining whether a party is a related party in relation to all recoverable transactions, charges and securities.

R6. Retain the presumption of insolvency in relation to transactions and charges in the six months prior to the commencement of a liquidation.

R7. Reduce the deadline for liquidators to file in the High Court claims under sections 292 to 299 from six to three years.

R8. Provide the High Court with the discretion to extend the filing period under sections 292 to 299 if it would be just and equitable to do so.

R9. Add a defence for a creditor with a valid security interest who can demonstrate that there was no preference at the time they received payment.

R10. Simplify the continuing business relationship rule in section 292(4B) of the Companies Act by removing the subjective element relating to the parties' intentions.

R11. Clarify that the starting point for a continuing business relationship is the start of the specified period or the point of the debtor's insolvency, whichever is later.

58 *Timberworld v Levin* [2015] 3 NZLR 365.

Chapter 3: Procedural issues

113. Improvements can be made to the procedures used under the voidable transactions and other recoveries regime. We have considered the following issues:

A. information provided by liquidators to creditors;
B. the start of the specified period when liquidation follows voluntary administration;
C. the application of recoveries to unsecured creditors;
D. the basis for sending notices;
E. a materiality threshold for setting aside transactions; and
F. ring fencing proceeds from voided transactions and charges.

114. We propose changes in relation to A-C (see recommendations 12-15), but do not recommend any changes in relation to D-F.

A. Information provided by liquidators to creditors

115. Section 294 of the Companies Act prescribes the procedure for setting aside transactions and charges. Subsection (2) prescribes the contents of the notice that must be filed with the court and served on the affected parties, which are as follows:

- the liquidator's contact details;
- specify that the transaction or charge to be set aside;
- describe the property or state the amount the liquidator seeks to recover;
- state that the person named may object to the transaction or charge being set aside by sending to the liquidator a written notice of objection within 20 working days;
- state that the transaction or charge will be set aside as against the person named in the notice if that person does not object; and
- state that if the person named in the notice does object, the liquidator may apply to the court for the transaction to be set aside.

116. There are three problems with section 294(2).

117. First, as the Legislation Advisory Committee notes, it is not always appropriate or possible for Parliament to deal with all of the detailed underlying systems and structures that give effect to an Act. In these cases Parliament often includes in an Act a provision that authorises another body, usually part of the executive, to exercise some of its law-making functions to deal with those detailed underlying systems.[59] This is clearly the case in relation to the details to be included in a liquidator's notice. Rather than being included in the Companies Act, those matters should be prescribed by Order in Council.

118. Second, there are no standard requirements to provide information about the transaction or charge to be voided. This has resulted in large differences in the quality of information liquidators provide to creditors. The Order in Council should require the liquidator to provide a standard set of information about the transaction or charge to be voided, as specified in recommendation 13(b) below.

119. Third, some creditors who receive a voidable transactions notice from a liquidator will have never received such a notice before, or even be aware that the voidable transactions regime exists. In addition to the classes of information listed above, these creditors also need basic information about the voidable transactions regime. To that end, we consider that the Order in Council should require liquidators to provide additional information, as specified in recommendation 13(c) below.

[59] Legislation Advisory Committee, *Guidelines on Process and Content of Legislation*, October 2014, p.49.

Recommendations

R12. Amend section 294, relating to the content and form of a liquidator's notice for setting aside transactions, by replacing the current list within section 294 itself, with a power to prescribe the content and form by Order in Council.

R13. Prescribe the following content under the Order in Council:

a) all matters currently prescribed by section 294(2) of the Companies Act 1993;

b) standard information about the transaction or charge to be voided, including:
   i. the date of the transaction;
   ii. the nature of the consideration;
   iii. the dollar value;
   iv. the parties to the transaction; and
   v. where there is a continuing business relationship, the date and dollar value of all transactions forming part of the relationship; and

c) basic information about the voidable transactions regime that will be helpful to creditors who are unfamiliar with the regime, including:
   i. the essential criteria for setting aside any transaction or charge;
   ii. the rules under the creditor's defence; and
   iii. the benefits of obtaining legal advice.

B. The start of the specified period when liquidation follows voluntary administration

120. At present, the two year clawback period is calculated by reference to either the date of liquidation, or the date on which an application to liquidate is filed in the court. We have identified a discrepancy in the legislation in relation to voluntary administrations (VA).

121. Where the liquidation occurs after the appointment of a voluntary administrator, the clawback period is calculated by reference to the date of the watershed meeting of creditors, which is when the liquidator is appointed, if that is what creditors decide. The effect is that the clawback period commences later than would be the case if the company was placed in liquidation in the first instance. The later date for calculating the clawback period can disadvantage creditors, because it means that some transactions that would ordinarily have been voidable are excluded from the regime for no reason other than the later date for calculating the clawback period.

122. This issue will become especially acute should the clawback period be reduced from two years to six months as recommended above. A VA can last for about six weeks on the prescribed timetable but it can be much longer. Either the watershed meeting could be adjourned for up to a month, or the court can extend the convening period. In such extensions, the VA can last for six months or longer. VA imposes a moratorium on creditors to allow time to investigate a rescue plan. If a rescue plan is not possible, creditors should not be disadvantaged by the fact of the VA. In exchange for their rights against the creditor standing still during the VA, so too should the benefits of potential voidable transaction claims stand still.

123. To ensure that the collective interests of creditors are not disadvantaged, we recommend that the Companies Act be amended to provide that the clawback period be calculated by reference to the date that the administrator is appointed. However, this rule would not apply where the debtor company and its creditors have entered into a deed of company arrangement.

Recommendation

R14. Provide that the clawback period commences from the date of appointment of the voluntary administrator if the creditors decide to appoint a liquidator at the watershed meeting.

C. The application of recoveries to unsecured creditors

124. Avoided transactions are applied to unsecured creditors, and are not subject to security interests.[60] However, there is some debate over whether it is appropriate for preferential creditors under Schedule 7 of the Companies Act, such as employees and the Inland Revenue, be paid from the recoveries of voidable transaction claims.[61]

125. We consider that recoveries under sections 292, 293 and 297 to 299 should be paid in the order set out in Schedule 7 and recommend that the Act be amended to clarify this point. This approach would be consistent with the scheme of the Companies Act.

Recommendation

R15. Clarify that the recoveries under sections 292, 293 and 297 to 299 should be paid out in the order specified under Schedule 7 of the Companies Act.

D. The basis for sending notices

126. Some liquidators send speculative notices and letters to all creditors seeking to avoid transactions without an obvious or stated basis for doing so. The Companies Act does not prevent a liquidator (who may otherwise comply with the prescribed notice) sending notices in relation to any and all transactions between the creditor and the debtor, including notices in relation to transactions that the liquidator knows (or should know) are not recoverable under the regime. Liquidators are effectively leaving it to the creditor to raise an appropriate defence. There are costs involved in both making and defending voidable transaction claims.

127. Anecdotal evidence suggests that some creditors will pay back the payment on receipt of a notice from a liquidator even if there is no basis for the claim from the liquidator, because of the perceived authority of the liquidator, in ignorance of the creditor's defence or from a desire to avoid the costs and difficulties objecting to a notice. While such payments may benefit the liquidator and the pool of unsecured creditors, it imposes unnecessary cost and stress on individual businesses.

128. We considered recommending introducing a statutory requirement for liquidators to explain, in a formal notice to a creditor, the exact basis the transaction or charge specified in the notice is claimed to be void. This would mean that, in addition to covering the 'what' matters specified in recommendation 13(b) above, the liquidator would also need to explain why the transaction is voidable. However, we consider that this issue is better addressed through the licensing regime that the Government has agreed to add to the Insolvency Practitioners Bill that is currently in the House.

129. We anticipate that the licensing regime would lead to codes of conduct being provided by the licensing body. Such codes are likely to include requirements for a liquidator to explain the basis for a voidable transaction claim. Any assertions that a liquidator has not provided an adequate explanation could be addressed through the enforcement of professional codes of conduct.

[60] *Re Yagerphone Ltd* [1935] 1 Ch 392, *Re Hibiscus Coast Marine Centre Ltd* (1986) 3 NZCLC 99, 615.

[61] Schedule 7 of the Companies Act sets out the priority of payments to preferential creditors.

E. A materiality threshold for setting aside transactions

130. We have considered whether a materiality threshold for setting aside transactions should be introduced into the Companies Act. While Australia does not have a threshold, the *United States Bankruptcy Code* has a minimum of US$6,425.

131. While we consider that there could be merit in establishing a threshold to ensure that the potential recovery merits the time and costs being expended in making and defending the application, we do not recommend this change should be pursued. The administration costs incurred by a liquidator provide a constraint on making small claims. In addition, introducing a threshold amount would raise other issues, including how to determine the amount and how frequently the amount would be reviewed.

F. Ring fencing the proceeds from voided transactions and charges

132. Some creditors view the voidable transactions regime cynically. They consider that the claims are being brought in order to profit liquidators (by being used to pay their fees and expenses or otherwise contribute to the costs of liquidation), rather than being applied to redress the balance between creditors. This may be true in some cases, but not others.

133. A possibility could be to amend the Companies Act to require liquidators to ring-fence proceeds from voidable transaction claims and make them available to unsecured creditors without further deduction, other than the cost of the claims themselves.

134. Although there appears not to have been a court decision on this point in New Zealand, the Australian courts have made it clear that proceeds of voidable transaction claims can be applied towards the liquidators' general costs in liquidation.[62] Our view is that the law in New Zealand is and should continue to be the same.

135. In addition, we consider that this matter is similar to the issues discussed above in relation to liquidators issuing notices without proper basis. We consider this matter would be addressed through codes of conduct and best practice guidelines issued under the co-regulatory licensing regime.

Recommendations – Chapter 3

R12. Amend section 294, relating to the content and form of a liquidator's notice for setting aside transactions, by replacing the current list within section 294 itself, with a power to prescribe the content and form by Order in Council.

R13. Prescribe the following content under the Order in Council:

a) all matters currently prescribed by section 294(2) of the Companies Act 1993;

b) standard information about the transaction or charge to be voided, including:
   i. the date of the transaction;
   ii. the nature of the consideration;
   iii. the dollar value;
   iv. the parties to the transaction; and
   v. where there is a continuing business relationship, the date and dollar value of all transactions forming part of the relationship as if they constituted a single transaction; and

c) basic information about the voidable transactions regime that will be helpful to creditors who are unfamiliar with the regime, including:

[62] *Re Starkey* [1994] 1 Qd R142 at 154.

i. the essential criteria for setting aside any transaction or charge;
ii. the rules under the creditor's defence; and
iii. the benefits of obtaining legal advice.

R14. Provide that the clawback period commences from the date of appointment of the voluntary administrator if the creditors decide to appoint a liquidator at the watershed meeting.

R15. Clarify that the recoveries under sections 292, 293 and 297 to 299 should be paid out in the order specified under Schedule 7 of the Companies Act.

Chapter 4: Ponzi schemes

What are Ponzi schemes?

136. A Ponzi scheme is a fraudulent investment scheme where the operator, whether an individual or an entity, pays returns to investors from new capital paid to the operators by new investors, rather than from profit earned by the operator. The scheme will usually lack substance and will not usually be a genuine business undertaking. Operators of Ponzi schemes entice investors by offering returns that are much higher than market rates of return. They often promise a consistent return from one period to the next.

137. The administration of Ponzi schemes can be relatively sophisticated because they rely on new investors to keep running. Occasionally they begin as legitimate businesses, until the business fails to achieve the returns expected, or the business itself experiences a loss due to fraud. Whatever the initial situation, a Ponzi scheme requires an ever-increasing flow of money from new investments to sustain the scheme and pay high returns to earlier investors.

138. The process of recovering lost investor funds from failed Ponzi schemes begins once the scheme collapses, at which point the scale of the inevitable investor losses become evident. In the case of Ross Asset Management (**RAM**), the first liquidator's report in 2012 stated that only assets of around $10 million remained of the net $115 million reportedly contributed by investors. Investor statements in 2012 reported around $450 million in investments being managed by RAM.[63]

Ponzi schemes and insolvency law

139. Ponzi schemes are unusual in New Zealand although, as evidenced by RAM, total investor losses can be very large. Subsequent financial market reforms, including the Financial Markets Conduct Act 2013, make it much harder for Ponzi schemes to operate and provide greater discipline on those obtaining and using investors' money.

140. The purpose of corporate insolvency law is to provide a legal mechanism to address the collective satisfaction of the outstanding claims from assets (both tangible and intangible) of the debtor company. Its purpose is not therefore to prevent or address investment fraud. With this in mind, we consider that Ponzi scheme deterrence and recovery issues should continue to be addressed through financial markets legislation and fall within the domain of the Financial Markets Authority.

141. However, it is essential, under insolvency law and other legislation, to provide a fair and efficient procedure for liquidating Ponzi schemes, recover whatever funds might remain and distribute them among investors. This is particularly important for investors who have retired from the work force and have invested most or all of their retirement savings into a scheme which, unknown to them, is a Ponzi scheme. The current processes are not as efficient as they could be.

142. There are a number of avenues available to recover lost investor funds. A liquidator may take action against investors to claw back payments made to investors prior to the scheme's collapse under the voidable transactions regime in the Companies Act 1993, and the prejudicial dispositions regime under sections 344 to 350 of the Property Law Act 2007 (**PL Act**). The liquidator may also take action against the owner or operator, for example to seek restitution for knowing receipt of funds in breach of trust, dishonest assistance (to a trustee to disperse trust funds in breach of trust) and, possibly, unjust enrichment.

143. The Crown may take action against the owner or operator of the scheme under the forfeiture provisions under the Criminal Proceeds (Recovery) Act 2009. Investors may seek to recover their investments from the assets held by the liquidator of the scheme through proprietary

[63] http://www.pwc.co.nz/PWC.NZ/media/pdf-documents/receiverships/ross-group/ross-group-companies-first-report-to-creditors-december-2012.pdf.

tracing claims.

Voidable transactions regime

144. Although it may be convenient for the liquidator to use the voidable transaction regime to claim back payments made to investors, the regime was never intended nor designed to address fraudulent behaviour.

The Property Law Act

145. The court may make an order under section 348 of the PL Act clawing back a debtor's dispositions of property to third parties where the debtor, when disposing of the property:

- intended prejudice to the creditor, or gift it, or did so without receiving reasonably equivalent value in return; and
- was insolvent or became insolvent, engaged or was about to engage, in business or a transaction for which the remaining assets were unreasonably, or intended to incur, believed, or reasonably believed, that the debtor would incur debts beyond the debtor's ability to pay.

146. This test is met if the debtor is unable to pay all of its debts as they fall due from assets other than the property disposed of.[64]

147. Section 349 contains two protections for third parties that obtained property:

- section 349(1) states that a third party can defend any application to the court if they show that they acquired the property for valuable consideration and in good faith without knowledge of the fact that it had been a prejudicial disposition;[65] and
- section 349(2) states that the court may decline to make a clawback order, or make an order of limited effect, if:
    - o the person received the property in good faith and without knowledge; and
    - o has changed his or her position so that it would be unjust to require them to restore the property or compensate the prejudiced creditor.

Court cases involving Ross Asset Management

Fisk v McIntosh

148. The voidable transactions regime under the Companies Act and the prejudicial dispositions regime under the PL Act are being applied in *Fisk v McIntosh*. In this case, an investor (McIntosh) obtained payments before the collapse of the RAM Ponzi scheme. The payment included repayment of McIntosh's investment and a fictitious profit earned on the investment.

149. The High Court decided that *bona fide* investors are able to retain repayments up to the amount of their net principal investment, but not fictitious profits. The Court of Appeal confirmed the decisions in the High Court that Mr McIntosh could retain the initial investment because he was able to satisfy the creditor's defence (including the 'gave value' rule as clarified by the Supreme Court in *Allied Concrete*), but he should repay the fictitious profits to the liquidators for the benefit of all creditors.

150. On 27 July 2016 the Supreme Court heard an appeal by Mr McIntosh and the cross-appeal from the liquidator of the Court of Appeal decision. No decision had been issued at the time of writing.

151. After the hearing, the Supreme Court requested that the parties provide additional submissions on whether the liquidators could recover money paid by RAM to an investor

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[64] Property Law Act 2007, s 345(1)(d).
[65] Property Law Act 2007, s 349(1).

prior to its liquidation based on the English case of *Re Diplock*. In *Re Diplock* an executor distributed money to charities under a will that was later held to be invalid. The court held that the charities had to repay the money they received. This was the case even though the charities received the money in good faith and believed that they were entitled to receive the money.

Priest v Ross Asset Management

152. In *Priest v Ross Asset Management Limited*,[66] the High Court held that Priest was entitled to claim various shares valued at around $2 million because they were held on a bare trust by RAM. The liquidator lodged a notice of appeal to the Court of Appeal, arguing that the shares formed part of the general body of assets available to RAM's investors. However, the case has now been settled out of court.

Possible reforms

153. There are several options for improving the efficiency and fairness of Ponzi scheme liquidations. Although we discuss possible changes below, we consider that it would not be appropriate to recommend changes before the Supreme Court releases its decision. There are two potential areas for change: aiding the recovery of funds and improving compensation.

Aiding the recovery of funds

154. One option would be to amend the PL Act to confirm the High Court decision in *Fisk v McIntosh* that the 'gave value' element of the defence is not satisfied by receiving fictitious profits, subject to the good faith and change-of-position defence.

155. Another option could involve amending the PL Act's prejudicial dispositions provisions in accordance with the law in the United States:

- to introduce a 'Ponzi presumption' to establish that Ponzi scheme investors are creditors without needing to prove an intent to defraud, or the debtor's insolvency; and
- to impose an objective standard for the good faith defence under section 349 of the PL Act where a Ponzi scheme is established.

Ponzi presumption

156. This would involve amending the PL Act to provide that where it is established that the debtor operated a Ponzi scheme and that the relevant transfer of funds was made in furtherance of the scheme, actual fraud or constructive fraud are to be presumed. The onus would instead be placed on the recipient to establish their defence.

157. A Ponzi presumption would aid recoveries in two ways. First, investors would not need to prove that the debtor had an intention to defraud, hinder or delay creditors. This change could make a big difference because it is difficult for investors to meet this requirement. Second, it would avoid the need for investors to prove that the debtor was insolvent or nearly insolvent pursuant to a constructive fraud action.

158. The main argument against establishing a Ponzi presumption relates to the difficulties of defining what constitutes a 'Ponzi scheme'. It will not always be clear whether a debtor was running a Ponzi scheme or engaging in legitimate business activity. For example, a failing company may have the appearance of a Ponzi scheme as the debtor transfers incoming receipts to meet outgoings.

Good faith defence

159. Generally speaking, a Ponzi investor acting in good faith is able to retain receipts up to the amount of their principal contribution under section 349 of the PL Act to the extent they gave value in return. It is a subjective test into the investor's actual knowledge.

[66] [2016] NZHC 1803.

160. There is a departure from that approach in the United States in cases of actual fraud, but not constructive fraud. It is harder for a defendant to retain any payments in these circumstances because they need to meet a ‘reasonable investor’ standard of proof in relation to both the notice and investigation elements.

Compensation

161. In the United States, shortfalls in investor recoveries following fraud are in part addressed by providing recourse to a federal fund administered by the Securities Investor Protection Corporation (**SIPC**) under the Securities Investor Protection Act of 1970. The fund comprises contributions levied from members of the SIPC (i.e. registered brokers and dealers) and interest on United States government securities acquired by the SIPC. Currently the fund is worth over US$2 billion.

162. The fund compensates each investor’s losses up to US$500,000 in the event of broker or dealer failure or fraud. The fund does not, however, compensate losses made on investments as a result of market fluctuations or a stock’s ‘poor performance’.

163. Such schemes have the potential to provide significant investor protection and thereby promote investor confidence in the market. However, if such schemes are to provide meaningful compensation then they will also reduce the risk of investment and, therefore, reduce the incentives to invest prudently. Policy and economic analysis would be required to determine whether the benefits would outweigh the costs in the New Zealand context. Identifying the right targets for contributions may also be problematic.

164. We consider that the small size of the New Zealand market would count significantly against the establishment of some form of compensation scheme without government contribution or underwriting.

Ross Asset Management Investors Group

165. Ross Asset Management Investors Group (RAMIG) has asked us to review and report on many aspects New Zealand’s systems for regulating financial markets for the purpose of protecting small investors from fraudulent activity. Among other things, RAMIG asked us to review and report on:

- criminal offences and penalties for defrauding investors;
- reparations by fraudsters;
- tagging and tracing investors funds;
- recovering funds from fraudulent investment schemes;
- provision of fidelity funds and insurance to protect small investors;
- performance and regulation of insolvency practitioners;
- responsibilities for detecting fraud; and
- designing retrospective legislation to provide fair and just outcomes for Ross Asset Management investors.

166. Most of the issues that RAMIG wanted us to review and report on fell outside our terms of reference. However, we consider two sets of changes will indirectly assist Ponzi scheme investors. First, the Government has agreed to our recommendation in Insolvency Working Group Report No. 1 to introduce a licensing regime for insolvency practitioners. Licensing should raise professional standards over time. Second, we include recommendations elsewhere in Report No. 2 to better protect the collective interests of creditors.

167. Our recommendation to change the period of vulnerability for voidable transactions will have the following impacts on the collective interests of the investors in a Ponzi scheme:

- in relation to unrelated parties, it will remove the opportunity for the liquidator to use the voidable transactions regime to claw back amounts from individual investors who serendipitously withdrew from the scheme at the right time, i.e. 6 to 24 months before the liquidator was appointed; and

- in relation to related parties, it will add the opportunity for the liquidator to use the voidable transactions regime to claw back amounts withdrawn from 2-4 years before the liquidator was appointed.

168. There would, however, be no impact on recoveries sought under the PL Act.

Conclusions on Ponzi Schemes

169. We consider that there is little, if anything, that can be changed under the voidable transactions regime that could benefit investors in Ponzi schemes. That said, subject to the outcome of the Supreme Court's decision in *McIntosh v Fisk*, there is scope to aid the recovery of funds by amending the PL Act:

- to confirm the High Court decision in *Fisk v McIntosh* that the 'giving value' element of the defence is not satisfied by receiving fictitious profits, subject to the revised creditor's defence recommended earlier in this report; and
- to amend the PL Act's prejudicial dispositions provisions to:
  - introduce a Ponzi presumption that establishes that investors are creditors and avoids the need to prove an intent to defraud, or of the debtor's insolvency; and
  - impose an objective standard for the good faith and change of position defence where a Ponzi scheme is established.

170. We note, however, that the PL Act applies to many forms of recovery, not just recoveries under Ponzi schemes. Hence, there are broader issues to consider, which are outside our terms of reference.

Recommendation

R16. After the Supreme Court releases its decision in *McIntosh v Fisk,* the Government should assess whether there is any need to make the following changes:

- aid the recovery of funds under the Property Law Act 2007 by adding a Ponzi presumption and/or a good faith defence; and
- the establishment of a compensation scheme.

Chapter 5: Other corporate insolvency law issues

171. The Terms of Reference also asked us to provide advice to the Minister of Commerce and Consumer Affairs on other corporate insolvency issues, specifically to identify if there are any other potential improvements to corporate insolvency law, and identify the main priorities for reform of corporate insolvency law.

172. We have identified a number of improvements within the Terms of Reference as we have understood them. Our recommendations appear below. Each is discussed in **Annex 2**. In summary, we recommend two types of changes:

- Changes aimed at improving the efficiency and effectiveness of corporate insolvency law. Many are technical changes designed to clarify provisions. This will reduce the cost to insolvent estates in debating or litigating points that are currently unclear.
- Changes which would alter allocations of funds in insolvencies by achieving a fairer allocation of resources.

Corporate restructuring processes in New Zealand

173. As the OECD recently noted, insolvency regimes should:

- incentivise the restructuring of viable firms and the liquidation of non-viable firms at low cost;
- balance the interests of the parties involved to ensure an equitable resolution without discouraging future risk taking; and
- provide for a timely resolution of insolvency.[67]

174. As provided for in the terms of reference, the focus of this report has largely been on the liquidation side of the picture, along with improvements to the Receiverships Act. We did not undertake a broader review of voluntary administration and the other restructuring options available in Parts 14, 15 and 15A of the Companies Act. We are not aware of any major issues with those systems and there is no evidence that wholesale changes are needed.

175. Nevertheless, it is important to ensure that those systems are accessible to financially distressed firms. We consider that it would be useful for the New Zealand Government to continue to monitor overseas developments.

176. We note, for example, that the Australian Government has agreed to adopt two corporate insolvency law recommendations made by the Australian Productivity Commission in 2015.[68] Those changes relate to safe harbours and *ipso facto* clauses and are outlined in Annex 2 Table 5. They are aimed at increasing the effectiveness of the Australian voluntary administration regime. Our assessment is that those reforms are not needed in New Zealand at present. However, it is important to keep them under review. A further assessment about their potential relevance to New Zealand should be made after the Australian Government makes the details of those changes public.

177. The Australian Productivity Commission recommended several other related changes. It would also be useful for New Zealand to keep up-to-date with any developments in relation to those other matters.

[67] OECD, *Insolvency Regimes and Productivity Growth: A Framework for Analysis*, Economics Department Working Paper No. 1309, ECO/WKP(2016)33, 1 July 2016, at paragraph 23.
[68] Productivity Commission Inquiry Report No. 75, *Business Set-up, Transfer and Closure*, 30 September 2015, recommendations 14.2 and 14.5.

Recommendations – Companies Act

R17. Amend, for the purposes of Part 16 (Liquidation), the definition of 'secured creditor' to include all creditors holding a security interest as defined in the Personal Property Securities Act 1999.

R18. Provide that recoveries from reckless trading claims are not available to secured creditors but instead are distributed only to unsecured creditors (including preferential creditors).

R19. Require all administrators' reports to be filed with the Registrar of Companies.

R20. Provide powers to liquidators to obtain certain information from third parties without needing to apply to the courts.

R21. Align the meaning of 'telecommunications services' in the Companies Act and the Receiverships Act 1993 with the meaning of 'telecommunications service' in the Telecommunications Act 2001.

R22. Provide that fines and penalties are admissible claims in liquidation, but are subordinate to claims by unsecured creditors.

R23. Allow communication by electronic means between the liquidator and creditors.

Recommendations – Preferential claims under Schedule 7 of the Companies Act

R24. Clarify whether long service leave forms part of the preferential claim for employees.

R25. Establish a new preferential claim for gift cards and vouchers, with the same ranking as layby purchases.

R26. Place a six month limit on the preferential claims for amounts unpaid to the Commissioner of Inland Revenue and the Collector of Customs.

R27. Amend section 167 of the Tax Administration Act 1994, such that all claims for PAYE provable in a liquidation are to be paid in accordance with Schedule 7 of the Companies Act 1993.

Recommendations – Receiverships Act 1993

R28. Clarify that the priority for administrators' fees and expenses continues to apply when a company is both in receivership and administration.

R29. Align the priority in section 30(2) in respect of the assignment of accounts receivable with section 153(2)(b) of the Property Law Act 2007.

Recommendation – Statistical data

R30. The Registrar of Companies should collate and publish information from reports lodged by insolvency practitioners.

Chapter 6: Implications for personal insolvency law

178. It is desirable for the substance of the law to be the same for corporate and personal insolvency law. The changes recommended in this report should also be made to the Insolvency Act 2006, to the extent that they are relevant.

Recommendation

R31. Make changes equivalent to recommendations 1-13, 15, 17, and 24-27 to the Insolvency Act 2006.

Annex 1: Terms of reference

This document outlines the objectives, membership and deliverables for the Insolvency Review Working Group.

1. Objectives

The objectives of the Working Group are to:

- provide expert advice to the Minister of Commerce and Consumer Affairs (the **Minister**) on corporate insolvency law in New Zealand; and

- if appropriate, recommend possible changes to New Zealand's corporate insolvency regulatory system.

2. Background

The Companies Act 1993 and the Receiverships Act 1993 provide a menu of options, including liquidation, voluntary administration, receivership and compromises, in relation to companies that are in financial distress or may be heading towards financial distress.

The objectives of corporate insolvency law include:

- providing interested parties with appropriate incentives about whether to rehabilitate or liquidate a financially distressed company;

- discouraging directors or management from wasting the company's assets;

- ensuring all creditors of the same class are on an equal footing (i.e. the *pari passu* principle);

- providing collective debt resolution procedures that are managed by a single person;

- minimising the disruption to business activity by providing efficient insolvency procedures;

- promoting the efficient and effective operation of credit markets; and

- not undermining benefits of limited liability as a means to raise capital and encourage business risk taking and innovation.

In recent years a number of recurring issues have arisen with New Zealand's corporate insolvency law, particularly in the areas of voluntary liquidations, voidable transactions and the regulation of insolvency practitioners. A working group comprising insolvency practitioners and legal experts is being formed to investigate these issues and recommend improvements to corporate insolvency law.

3. Scope

The Working Group will provide the Minister with a report containing advice and recommendations on the matters outlined below, including analysis of the regulatory impacts of any proposed changes.

A Voluntary liquidations
Whether there are problems with voluntary liquidation of companies (including with respect to the use of phoenix companies and companies being liquidated to avoid liability for latent defects, paying arrears of wages to employees, other employee entitlements and employment related penalties) and, if so: • whether any problems are confined to the building sector or are of a general nature; • whether existing protections against abuse are effective;

• whether there are sufficient incentives for parties to use available civil remedies in cases of abuse; • whether there is benefit to be able to publically search for directors of companies which have gone into liquidation; and • how any problems could be dealt with by amending company law.	
B	**Voidable transactions and Ponzi schemes**
Continue examining the voidable transaction regime and provide advice on: • possible areas of reform of the voidable transactions regime; • whether there are any additional issues associated with the regime and, if so, how they could be addressed; and • any changes to company or investment law that could be proposed to aid the recovery of funds and compensation of lost funds by Ponzi scheme investors.	
C	**Insolvency Practitioners Bill**
Provide advice on whether the Insolvency Practitioners Bill should: • be withdrawn; • be progressed; • have elements progressed; or • be replaced with a licensing regime and, if so, identify the key features of the regime, how the licensing regime should be funded, and how the regime would impact on company insolvencies.	
D	**Other corporate insolvency issues**
• Identify if there are any other potential improvements to corporate insolvency law. • Identify the main priorities for reform of corporate insolvency law.	
E	**Implications for personal insolvency law**
Identify whether there would be any implications for personal insolvency law arising from any recommendations under B and D.	

Annex 2: Other corporate insolvency law issues

Table 1: Companies Act issues

No	Description	IWG Comment
1	**The definition of ‘secured creditor’** The scope of the definition of ‘secured creditor’ is particularly important for liquidators. In particular, secured creditors have no right to vote their secured debt at a creditors meeting,[69] liquidators can require secured creditors to elect whether to enforce their security, value the property subject to the security and claim for the balance or surrender the security for the general benefit of creditors.[70] More generally, references to ‘creditors’ in Part 16 excludes secured creditors save in specified sections.[71] A question arises whether creditors with title-based security are ‘secured creditors’ for the purposes of such provisions.[72] S 2 defines ‘secured creditor’ as “a person entitled to a charge on or over property owned by that company”. ‘Owned’ is not defined, but ‘charge’ “includes a right or interest in relation to property owned by a company, by virtue of which a creditor of the company is entitled to claim payment in priority to creditors entitled to be paid under s 313; but does not include a charge under a charging order issued by a court in favour of a judgment creditor.” The definitions clearly refer to and rely on the location of title (ownership) and the concept of an interest being granted to the creditor (charge). On their face, they do not extend to a security interest held by the owner of assets who has retained title. For example, a supplier under a conditional sale, or a lessor under a finance lease will continue to own the property in question. Such property does not become owned by the debtor, and the debtor does not grant any interest in it. The debtor, not being the owner, is not capable of granting any interest. Applying an orthodox legal understanding of the concepts of ownership and charge, it	We consider that the approach taken by the High Court in construing the Property Law Act is correct. If Parliament had intended the PPSA to alter the meaning of established concepts such as ‘charge’ and ‘owned’ in the Companies Act, it would have done so explicitly. It would be preferable for the Companies Act to address expressly whether ‘secured creditors’ includes all creditors holding a security interest in terms of the PPSA. It should accord with practice and assumptions by the commercial and insolvency community, namely that all types of security interests are effectively treated in the same way. If the definition of ‘secured creditor’ were to be changed to include all security interests, it would be necessary to consider whether that was appropriate in the parts of the Act outside liquidation. It may not, for example, be appropriate in the sections dealing with giving notice of amalgamations. For that reason, we limit our recommendation to Part 16 (Liquidation). **See recommendation 17**

[69] Companies Act 1993, ss 240 & 244: *Grant & Khov v Waipareira Investments Limited* [2014] NZCA 607.
[70] Companies Act 1993, s 305.
[71] Companies Act 1993, s 240.
[72] For example, sellers who have retained title and lessors under finance leases.

No	Description	IWG Comment
	follows that the definition of 'secured creditor' does not include a creditor under a retention of title clause. Nor does it include a lessor under a lease for more than one year (a deemed security interest under the Personal Property Securities Act 1999 (PPSA)). Both types of security interest are frequently encountered in insolvency practice. However, the PPSA treats all security interests alike, regardless of their legal form, i.e. regardless of whether they rely on an interest being granted to the creditor or retained by the creditor (e.g. through a retention of title clause). Further, each will be a statutory fixed charge regardless of the legal nature of the interest.[73] As a consequence, in insolvency practice creditors and insolvency practitioners have become used to dealing with all security interests as if they create the same essential legal rights. For most purposes, no distinction is drawn between the varying types of security, such as a fixed charge, floating charge, chattel mortgage, hire purchase agreement etc. That is not the case under the Companies Act. Strictly, the definition of 'secured creditor' continues to distinguish between creditors who hold security through being granted an interest in the debtor's property, and creditors who retain title to assets held or used by the debtor. Hence, it is unclear whether a 'charge' includes a security interest held by the owner of assets who has retained title, even if the legal form of the interest in question is not a charge, as traditionally understood. Conflicting decisions have emerged. 'Mortgage' in the Property Law Act 2007 is defined as a charge granted by the owner of the property in question. The High Court has held that title-based interests, which the PPSA would treat as 'security interests,' are excluded.[74] The Court of Appeal adopted a different approach under the Companies Act. In considering a retention of title clause, the Court said (in comments that are not strictly binding):[75] In pre-PPSA terms, the goods supplied by Sleepyhead would not have been owned by [the debtor] - they would have been wholly outside the liquidation because title remained with Sleepyhead. Now that the PPSA governs the	

[73] *Stiassny v Commissioner of Inland Revenue* [2013] 1 NZLR 453 (SC).
[74] *Mercedes-Benz Finance Services New Zealand Limited v Quadrant Wholesalers Limited* [2014] NZHC 814; *Mercedes-Benz Financial Services New Zealand Limited v Conway* [2015] NZHC 315.
[75] *Dunphy v Sleepyhead Manufacturing Co Ltd* [2007] 3 NZLR 602 (CA) at [36] and [37].

No	Description	IWG Comment
	method by which creditors obtain security, 'owned' must be read in a manner that is consistent with the PPSA, which means that [the debtor's] interest in the goods must be treated as sufficient for them to be 'owned' by [the debtor] for the purposes of this definition ... [Sleepyhead's] security interest is, therefore, a 'charge' and Sleepyhead is a 'secured creditor' as defined in s 2(1) of the Companies Act.	
2	**Misfeasance claims** Misfeasance claims, including reckless trading claims, are assets of the company. Security interests therefore attach to them. Although the duty is owed to the company, the claim is measured by reference to the losses suffered by the creditors. This can mean that relief is not ultimately applied to the loss by which it is quantified. At present, therefore, as happened in *Mason v Lewis*,[76] secured creditors recover the proceeds first, regardless of whether they suffered the relevant loss. Pursuing a reckless trading claim against directors would be pointless where the directors (or their interests) hold substantial secured debt. All recoveries would be paid first to the GSA-holder, i.e. the directors or their interests. In some cases, the period of reckless trading may have been to the disadvantage of unsecured creditors and to the advantage of the secured creditors. Nevertheless, the secured creditors remain entitled to the proceeds of the reckless trading claim.	We recommend that the Companies Act should be amended to provide that recoveries from reckless trading claims under s 135 of the Companies Act are for unsecured creditors only, as is the case in the United Kingdom and Australia.[77] **See recommendation 18**
3	**Report filing – inconsistent requirements** Under s 229 of the Companies Act the report containing background issues of a proposed compromise is required to be filed with the Registrar of Companies. Under voluntary administration the report sent to creditors prior to the watershed meeting only has to be filed with the Registrar under s 239ABZ if the company goes into liquidation. There is, however, no requirement for the voluntary administrator's report to be filed with the Registrar of Companies, irrespective of whether or not the company goes into liquidation.	We recommend that the Act should be amended to provide for the voluntary administrator's report to be filed with the Registrar for consistency and to improve transparency for creditors. Filing the report with the Registrar would not raise any confidentiality issues. **See recommendation 19**

[76] [2009] NZCA 306.
[77] See Corporations Act (Cth) s 588Y and *Re Oasis Merchandising Services Limited* [1998] Ch 170.

No	Description	IWG Comment
4	**The liquidator's power to obtain third party records** Although s 261 of the Companies Act gives liquidators the power to obtain the debtor company's documents, under s 266 the liquidator must apply to the court in order to access documents of third parties that relate to the debtor company.[78] Certain documents held by a third party (e.g. invoices, correspondence and credit notes) that the debtor company will have had at some point, may not be available to the liquidator because of poor record keeping by the company in liquidation. The time and cost associated with seeking a court order to obtain copies of the documents and costs sometimes deters liquidators from fully investigating the company's affairs.	We recommend that s 261 be amended to provide liquidators with the power to obtain such information from third parties without needing to apply to the courts. Such a procedure should only allow the liquidator to obtain information that would ordinarily have been available to the liquidator if proper records had been kept by the company in liquidation. It would not provide access to information that would otherwise be confidential to the third party, such as bank records and internal correspondence between the third party and other parties. **See recommendation 20**
5	**Definition of 'telecommunications services'** S 275 of the Companies Act 1993 and s 40 of the Receiverships Act 1993 prohibit refusing to supply essential services to a company in liquidation or receivership. The definition of 'essential services' in both Acts includes the following definition of 'telecommunications services': The conveyance from one device to another by <u>a line, radio frequency, or other medium, of</u> a sign, signal, impulse, writing, image, sound, instruction, information, or intelligence of any nature, whether or not for the information of a person using the device. (emphasis added) The Law Commission had recommended this definition in 1989. It appears that the Commission derived it from the definition of 'telecommunication' in s 2 of the Telecommunications Act 1987 (the 1987 Act).[79] However, the definition in the 1987 Act did not include the words underlined above. In contrast to the 1987 Act, the replacement Telecommunications Act 2001 (the 2001 Act) defines both 'telecommunication' and 'telecommunications service':	There are clear differences between the definition of 'telecommunications services' in the Companies Act and Receiverships Act and 'telecommunications service' in the 2001 Act. However, there are no sound reasons for this. Although we cannot be sure, it appears that it was simply an oversight that the outdated definition in the Companies Act and Receiverships Act was not replaced via Schedule 4 of the 2001 Act. We are, therefore, recommending that the definition of 'telecommunications services' in the Companies Act and Receiverships Act be replaced with the definition of 'telecommunications service' in the 2001 Act. One way of doing this would be to incorporate the 2001 Act definition by reference. This will ensure that any future change to the definition in the 2001 Act will also apply under insolvency law.

[78] *Official Assignee v Grant Thornton* [2012] NZHC 2145 and *ANZ National Bank Ltd v Sheahan* [2012] NZHC 3037, [2013] NZLR 674.
[79] The 1987 Act did not define 'telecommunications services'.

No	Description	IWG Comment
	Telecommunication– (a) means the conveyance by electromagnetic means from one device to another of any encrypted or non-encrypted sign, signal, impulse, writing, image, sound, instruction, information, or intelligence of any nature, whether for the information of any person using the device or not; and (b) for the purposes of subpart 2 of Part 4, includes any conveyance that constitutes broadcasting; but (c) for all other purposes, does not include any conveyance that constitutes broadcasting. *Telecommunications service* means any goods, services, equipment, and facilities that enable or facilitate telecommunication.	**See recommendation 21**
6	**Priority of fines, penalties and costs** S 303(2) provides that fines, monetary penalties and costs to which s 308 applies are not claims that may be admitted against a company in liquidation. S 308 provides that liquidation does not "limit or affect recovery of" fines and penalties for breaches of statute, and costs on such claims. This effectively means that the Crown can stand outside the liquidation and take advantage of the procedures available to it, had the company not been in liquidation, to recover the fines, monetary penalties and costs specified in s 308.[80] It is not subject to the usual moratorium imposed on creditors by s 248(1)(c). S 308 is similar to s 232 of the Insolvency Act 2006 because the bankrupt is released from liability for provable debts, except fines and certain other debts. However, the difference with liquidation is that the company ceases to exist. There is, therefore, no discharge from which to exclude fines and similar liabilities.	The main argument against allowing fines and penalties to be proved and paid in liquidation is that it punishes innocent parties (i.e. the company's unsecured creditors), not the wrongdoer (i.e. the owners of the company) by reducing the pool assets available for distribution. The opposing argument is that a fine or penalty can be seen as a claim by the community on the company and should, therefore, be included alongside other unsecured creditors.[81] At present, the Companies Act does neither. Instead, it gives fines and penalties a priority above unsecured creditors, if the fine is enforced. We consider that the first argument has considerable force. Payment of a fine by an insolvent company punishes the company's unsecured creditors, not the owners or managers of the company. We consider that unsecured creditors should be paid ahead of fines and penalties. But if a company in liquidation is solvent, the

[80] John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Thom Reuters, Wellington, 2013).
[81] Law Commission *Company Law Reform and Restatement* (NZLC R9, 1989) at [704].

No	Description	IWG Comment
		fine should be paid from company assets. Otherwise, the owners of the company escape the fine or penalty completely. We recommend that fines and penalties should be provable claims, but be subordinate to claims made by unsecured creditors. **See recommendation 22**
7	**Electronic communication** Ss 387-392 provide for the service of documents on directors, companies, overseas companies, shareholders and creditors. The Electronic Interactions Reform Bill, which is currently in the House, will provide for the greater use of electronic means of communication under a number of statutes, including some Companies Act provisions. However, that Bill relates only to provisions in legislation where the government interacts with another party. For example, it contains an amendment to s 390 related to service of documents on overseas companies to clarify that documents may be emailed to an email address used by the overseas company. Other provisions in the Companies Act continue to impose barriers on the ability of insolvency practitioners to communicate with creditors by email and other electronic means. Consequently, insolvency practitioners need to obtain court orders to communicate by electronic means with the body of creditors. This is inefficient. It is also a barrier to creditors obtaining timely information, which is often important during an insolvency event.	We recommend that amendments be made to allow communication by electronic means: • to send notices to any creditor via an email address obtained by the insolvency practitioner from the creditor, or which was used by the company for communicating with that person; and • to provide reports and other documents to creditors by publishing them on websites and electronically notifying creditors. **See recommendation 23**

Table 2: Preferential claims under Schedule 7 of the Companies Act

No	Description	IWG Comment
8	**Employee preferences – long service leave** Clause 1(2) of Schedule 7 of the Companies Act 1993 provides for the payment of preferential claims of employees in an insolvency of a company. The total amount that any employee can obtain is capped at a certain dollar amount. The maximum is increased every three years by Order in Council in accordance with movements in the average weekly earnings in the Quarterly Employment Survey published by Statistics New Zealand. The current maximum is $22,160. There is uncertainty among liquidators and legal practitioners who specialise in insolvency law about whether long service leave (LSL) is included within the scope of clause 1(2). The uncertainty arises because holiday pay is relevantly defined in Schedule 7, clause 3(4)(a), to include all sums payable under certain provisions in the Holidays Act 2003, "*and includes all sums that by or under any … agreement, or contract of service are payable to that person by the company as holiday pay*". Employees rely on that part of the definition to argue that LSL is holiday pay that is payable under an agreement of contract. The opposing argument is that such leave is not holiday pay as such so is not included. The ambiguous nature of the provision is unhelpful. In addition, there have been no court decisions to clarify the law. The uncertainty in relation to LSL contrasts with the situation in relation to other contract-based entitlements, such as accrued redundancy, which is expressly within the scope of clause 1(2).	The uncertainty means that there is no uniform practice among liquidators. Hence, there can be arbitrary and indiscriminate outcomes. We consider that clarity is needed, both to provide liquidators, employers and employees with certainty, and to remove the risk of unnecessary litigation. We do not have strong views about whether or not LSL should or should not be included within the scope of the employment-related preferential claim. Hence, we limit our recommendation to stating that the government should provide clarity. **See recommendation 24**
9	**Gift card and gift voucher holders** The collapse of Dick Smith Electronics shortly after Christmas in 2015 has highlighted that there is no preference in connection with gift cards, gift vouchers and other similar items.[82] Hence, the holders are unsecured creditors. This will often mean that the person will receive nothing in the event of company insolvency.	We consider that a priority should be established for gift cards and vouchers for consumer protection reasons. 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 gift voucher at a later date. In addition, the amount involved in connection with gift cards and vouchers is usually only a small proportion of the total debt owed to all creditors. It is unlikely to

[82] This issue relates only to pre-payments to be used as an alternative to cash for purchases within a particular store or related businesses.

No	Description	IWG Comment
		materially harm the interests of other creditors. We recommend that gift card and gift voucher holders be given a preference ranking equally with an existing preference for lay-by sales. This would place gift cards and vouchers behind the employee preferences, but ahead of the Inland Revenue Department and the New Zealand Customs Service. **See recommendation 25**
10	**The Inland Revenue Department's preferences** Schedule 7 of the Companies Act provides the Commissioner of Inland Revenue with preference claims in relation to certain types of taxation-related amounts that were payable or to be deducted under the Tax Administration Act 1994. This situation is in contrast to other countries, including Australia where the Australian Tax Office lost its preferential status in the 1990's at the same time voluntary administration was established. Since then, all tax debts have ranked equally with other unsecured creditors. It was considered that the priority had to be abolished for the new voluntary administration regime to succeed. The goal of abolition was to ensure that a company either meets its obligations, or goes promptly into liquidation or voluntary administration.[83] The United Kingdom also removed Crown preferences from the *Insolvency Act 1986*, following the enactment of the *Enterprise Act 2002*. One perspective is that the priority in New Zealand is justified because Inland Revenue is an involuntary creditor. We note, however, that the revenue departments in Australia and the United Kingdom are similarly involuntary but there are no equivalent priorities in those countries. In addition, we consider that Inland Revenue is well placed to protect its interests for two main reasons. First, Inland Revenue is usually in a better position than other creditors to detect insolvency at any early date because a company that is financially distressed will often defer or stop paying taxes first. There are other early warning signals such as the option	We recommend that the preference claim should be limited to six months commencing from the date the debt falls due. Thereafter the Inland Revenue would become an ordinary unsecured creditor. For example, if a company entered liquidation on 1 July 2017, the tax that became payable to the Commissioner of Inland Revenue between 1 January and 30 June 2017 would be preferential claims. Inland Revenue would be an ordinary unsecured creditor for amounts that were payable prior to 1 January 2017. Interest and penalties that became payable during the six months would continue to not have a priority. **See recommendation 26**

[83] Catherine Brown, Queensland University of Technology, undated powerpoint, http://docs.business.auckland.ac.nz/doc/10-catherine-brown-presentation.pdf.

No	Description	IWG Comment
	for companies to file GST returns in one-monthly or two-monthly taxable periods. Second, Inland Revenue has extensive protections and powers under the Tax Administration Act 1994 that are not available to other creditors. For example: • Part 3 provides the Commissioner with extensive information-gathering powers; and • s 157 states that where a taxpayer has defaulted in payment of any income tax, or related interest or civil penalty, the Commissioner may serve a notice on any person to deduct or extract an amount payable from the taxpayer's bank account, wages or salary.	
11	**The New Zealand Customs Service preference** Schedule 7 of the Companies Act provides the Collector of Customs with preference claims in relation to duties payable, as defined in the Customs and Excise Act 1986. The Collector of Customs and the Commissioner of Inland Revenue have the same preferential status. Both are involuntary creditors. However, Customs is, if anything, in an even stronger position because it has the power to withhold the release of imported goods, or similarly the export of goods, if the payment of duties is not made. Even if release occurs, Customs has a special statutory preference through a charge on the goods.[84]	Given Customs' strong position, we consider the preference claim should be limited to six months commencing from the date the debt falls due. Thereafter Customs would become an ordinary unsecured creditor. **See recommendation 26**
12	**Prioritisation of PAYE payments after liquidation** The Supreme Court decision in *Jennings Roadfreight Limited (In Liquidation) v Commissioner of Inland Revenue*[85] decided that the IRD stands behind liquidators and employees when cash is available in the liquidation and PAYE is overdue for payment and unpaid at the date of appointment. This decision upholds the payment position in Schedule 7 of the Companies Act. However, it appears that PAYE falling due for the payment after the date of liquidation or receivership, in respect of a pre-liquidation period, gains additional priority if there are funds in the company's bank account on appointment of the liquidator or receiver. S	We recommend that amendments be made to s 167 of the Tax Administration Act so that no super priority is given to PAYE provable in liquidation beyond that of Schedule 7 of the Companies Act. We consider that PAYE falling due for payment after the date of liquidation or receivership, in respect of the pre-liquidation period should be treated the same as PAYE that is overdue. We consider the current distinction to be arbitrary and that Schedule 7 should be the reference

[84] *JHR Fisk and CT McCloy v Attorney-General on behalf of the Comptroller of Customs* [2016] NZHC 479.
[85] [2014] NZSC 160.

No	Description	IWG Comment
	167(1) of the Tax Administration Act 1994 applies in that case.	point for determining the priority of payments of preferential claims in corporate insolvency. **See recommendation 27**

Table 3: Receiverships Act issues

No	Description	IWG Comment
13	**Priority of voluntary administrator's fees when a receiver is appointed** A receiver can be appointed during a voluntary administration. When that happens the receiver takes control of the assets over which a security is held (often all the assets of the debtor company) including cash and other liquid assets. However, the administrator has a statutory obligation to complete an investigation, report to creditors and hold a creditors' meeting. The question then arises as to whether the administrator has a priority claim over the assets of the debtor company for their fees and expenses. This is not clear under the Companies Act or Receiverships Act. *Companies Act provisions* • S 239ADL states that the administrator is indemnified out of the company's property in respect of their remuneration and for personal liability incurred in the performance of their duties. • S 239ADM states that the right of indemnity has priority over all unsecured debts and over GSA's in respect of, among other things, accounts receivable and inventory. • S 239ADM is subject to section 312, which requires a liquidator to apply funds in the order of priority set out in Schedule 7 to the Companies Act. Administrators' costs are preferential in liquidation, but they are only payable from funds that are available after the security interests have been satisfied. *Receiverships Act provisions* • S 30(2) states that a receiver must apply the proceeds of accounts receivable or inventory that are subject to the security under which the receiver was appointed in the following order: o The receiver's costs and fees; o PMSI creditors and perfected assignees of accounts receivable; and o Preferential creditors in Schedule 7 (where administrators' fees and expenses are	The uncertainty arises because receivers and their appointing creditors usually claim that s 30(2) of the Receiverships Act does not cover administrators' fees and expenses. However, administrators claim that the statutory indemnity and lien in the Companies Act are expressly ranked ahead of unsecured creditors and GSA creditors in respect of accounts receivable and inventory. We consider that administrators ought to have the protection of the priority set out in s 239ADM, because the administrator is personally liable for the debts incurred by the trading in the voluntary administration period. It is unfair for the statute to impose that liability, but remove recourse to the company's assets simply because a secured creditor subsequently appoints a receiver. We recommend that the Receiverships Act be amended to clarify that administrators continue to have a priority for their fees and expenses when a company is both in receivership and administration. **See recommendation 28**

No	Description	IWG Comment
	listed in clause 1(1)). • S 30(2A) requires that the receiver pay the proceeds of inventory and accounts receivable in that order before paying the claims of any other person under a security interest.	
14	**Circularity of priority** S. 30(2) requires a receiver to pay an assignee of an account receivable ahead of preferential creditors and a General Security Agreement creditor (GSA creditor). However, the GSA creditor will have priority over the assignee if the assignee registered after the GSA creditor. In that case the following circularity arises: • the GSA creditor has priority over the assignee; • the assignee has priority over preferential creditors; and • the preferential creditors have priority over the GSA creditor. It becomes impossible to determine the order in which funds are to be applied, without a Court ruling that the provision is not to be taken at face value. The same priority situation is dealt with in s. 153 of the Property Law Act 2007. Both sections (s. 30 of the Receiverships Act and s. 153 of the Property Law Act) provide for preferential creditors to rank ahead of a general security interest over inventory and accounts receivable. Both sections create an exception for certain purchase money security interests and security interests created by the assignment of accounts receivable. The policy in each section is identical. The Receiverships Act will apply if a receiver enforces the mortgage. The Property Law Act will apply if the mortgagee itself enforces the mortgage. The two sections should therefore have the same effect (the mode of enforcement should not alter priorities). However, the sections have a key difference. The text in the Receiverships Act creates the circularity as set out above. S 153(2)(b) of the PL Act states that "…any perfected security interest arising from a transfer of accounts receivable for new value over the accounts receivable concerned, <u>to the extent that it has priority over the mortgagee's mortgage</u> and, in the case of the application of income, so far as payment is then due". S 30(2)(b)(ii) of the Receiverships Act states that "… a security interest over all or any of those assets, that has been perfected under the Personal Property Securities Act 1999 at	Although this situation may not arise often in practice, it should be corrected because it can create legal uncertainty when it happens. We recommend amending s 30(2) of the Receiverships Act 1993 to align with s 153(2)(b) of the Property Law Act 2007. By adding into s 30(2) the requirement that the security interest created by the assignment has priority over the relevant general security interests, the circularity that we are concerned about would be removed. **See recommendation 29**

No	Description	IWG Comment
	the time of the receiver's appointment and that arises from the transfer of an account receivable for which new value is provided by the transferee for the acquisition of that account receivable (whether or not the transfer of the account receivable secures payment or performance of an obligation).	

Table 4: Statistical data

No	Description	IWG Comment
15	**Improving the collection, availability and analysis of data on corporate insolvency** Very little data is collected, collated and published about the corporate insolvency system. This makes it difficult for industry bodies, academics, officials and others to assess the efficiency and effectiveness of the corporate insolvency system, or part or in whole, or to assess the potential impact of possible changes to the system. The paucity of reliable data has been an issue for us on a number of occasions in the course of preparing this report and last year's *Report No. 1* relating to the regulation of insolvency practitioners and voluntary liquidations.	We recommended in *Report No. 1* that insolvency practitioners prepare a summary report in a prescribed form at the end of an insolvency summarising the event and providing certain prescribed information for statistical purposes.[86] We are also now recommending that the Registrar of Companies should collate and publish information to better enable the performance of the insolvency system to be assessed. We consider that it would be useful for the Registrar to publish statistics relating to such matters as the number of companies entering each type of insolvency process, the number of insolvency appointments, the number of insolvency processes by region and industry and the duration of company insolvency processes. We also consider that it would be useful for the Registrar to publish complaints statistics after the forthcoming insolvency practitioner licensing regime comes into effect. **See recommendation 30**

[86] See paragraphs 112-114 and Table 3 of Annex 3.

Table 5: Issues that have arisen in Australia

No	Description	IWG Comment
16	**‘Safe harbour’ provision for directors** The Australian Government intends to introduce a ‘safe harbour’ for directors to facilitate the restructure of businesses. It would be designed to strike a better balance between encouraging entrepreneurship and protecting creditors. The safe harbours would apply to company directors who may be liable for insolvent trading under s 588G of the Corporations Act 2001. Liability can exist if: • the person was a director of a company at the time the company incurs a debt; • the company is insolvent at that time, or becomes insolvent by incurring that debt; and • at that time, there are reasonable grounds for suspecting that the company is insolvent, or would become insolvent. This provision, combined with uncertainty about when a company becomes insolvent have long been identified as a driver behind companies entering voluntary administration or liquidation, even in circumstances where the company may be viable in the long term. In addition, concerns over inadvertent breaches of insolvent trading laws are frequently cited as a reason why early stage investors and professional directors are reluctant to become involved in a start-up.	There is no duty in New Zealand “prevent insolvent trading”. The nearest equivalent duty relates to reckless trading under s 135 of the Companies Act and the substantive test is a “substantial risk of serious loss to the company’s creditors”. Consequently, this is a much higher test, so New Zealand directors’ have considerably less exposure to civil liability than Australian directors. We are not aware of any concerns that the reckless trading duty in New Zealand deters normal business risk taking activity or leads to overuse of the voluntary administration regime. We do not see any need to adopt a safe harbour in New Zealand at this time. However, further consideration could be given to this issue once the Australian government releases the details of this change.
17	**Ipso facto clauses** *Ipso facto* clauses allow one party to a contract or agreement to terminate or vary the contract in specific circumstances. A common form of *ipso facto* clause allows a party to terminate a contract solely due to the commencement of formal insolvency proceedings, regardless of continued performance. For example, a company’s trade creditors might cease providing goods and services even though they are still being paid. The lack of protection from the operation of *ipso facto* clauses under Australian law has been a key criticism of the voluntary administration regime contained in Part 5.3A of the Corporations Act. They can further reduce the value of a business entering insolvency, reduce the scope for a successful restructure or prevent the sale of the business as a going concern. The Australian Productivity Commission recommended that the Corporations Act be amended such that *ipso facto* clauses that have the purpose of allowing termination of contracts solely due to an insolvency event are unenforceable if the company is in	We are not aware of *ipso facto* clauses being an issue in New Zealand. S 275 of the Companies Act and s 40 of the Receiverships Act provide protections by prohibiting a refusal to supply an essential service. It covers the retail supply of gas, the retail supply of electricity, the supply of water and telecommunications services. We do not see any need to make any *ipso facto* clause-related changes in New Zealand at this time. However, further consideration could be given to this issue once the Australian government releases the details of this change.

No	Description	IWG Comment
	voluntary administration or the process of forming a scheme of arrangement. The Australian Government has stated that it will make this change and extend it to include other types of *ipso facto* clauses (such as clauses that vary terms of a contract) which may be disproportionately detrimental to companies undertaking a restructure.	

Annex 3: The recovery provisions in the Companies Act 1993

Voidable transactions

292 Insolvent transaction voidable

(1) A transaction by a company is voidable by the liquidator if it—
- (a) is an insolvent transaction; and
- (b) is entered into within the specified period.

(2) An **insolvent transaction** is a transaction by a company that—
- (a) is entered into at a time when the company is unable to pay its due debts; and
- (b) enables another person to receive more towards satisfaction of a debt owed by the company than the person would receive, or would be likely to receive, in the company's liquidation.

(3) In this section, **transaction** means any of the following steps by the company:
- (a) conveying or transferring the company's property:
- (b) creating a charge over the company's property:
- (c) incurring an obligation:
- (d) undergoing an execution process:
- (e) paying money (including paying money in accordance with a judgment or an order of a court):
- (f) anything done or omitted to be done for the purpose of entering into the transaction or giving effect to it.

(4) In this section, **transaction** includes a transaction by a receiver, except a transaction that discharges, whether in part or in full, a liability for which the receiver is personally liable under section 32(1) or (5) of the Receiverships Act 1993 or otherwise personally liable under a contract entered into by the receiver.

(4A) A transaction that is entered into within the restricted period is presumed, unless the contrary is proved, to be entered into at a time when the company is unable to pay its due debts.

(4B) Where—
- (a) a transaction is, for commercial purposes, an integral part of a continuing business relationship (for example, a running account) between a company and a creditor of the company (including a relationship to which other persons are parties); and
- (b) in the course of the relationship, the level of the company's net indebtedness to the creditor is increased and reduced from time to time as the result of a series of transactions forming part of the relationship;

then—
- (c) subsection (1) applies in relation to all the transactions forming part of the relationship as if they together constituted a single transaction; and
- (d) the transaction referred to in paragraph (a) may only be taken to be an insolvent transaction voidable by the liquidator if the effect of applying subsection (1) in accordance with paragraph (c) is that the single transaction referred to in paragraph (c) is taken to be an insolvent transaction voidable by the liquidator.

(5) For the purposes of subsections (1) and (4B), **specified period** means—
- (a) the period of 2 years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and
- (b) in the case of a company that was put into liquidation by the court, the period of 2 years before the making of the application to the court together with the period commencing on the

date of the making of that application and ending on the date on which, and at the time at which, the order was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

(6) For the purposes of subsection (4A), **restricted period** means—

(a) the period of 6 months before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order of the court was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

293 Voidable charges

(1) A charge over any property or undertaking of a company is voidable by the liquidator if—

(a) the charge was given within the specified period; and

(b) immediately after the charge was given, the company was unable to pay its due debts.

(1A) Subsection (1) does not apply if—

(a) the charge secures money actually advanced or paid, or the actual price or value of property sold or supplied to the company, or any other valuable consideration given in good faith by the grantee of the charge at the time of, or at any time after, the giving of the charge; or

(b) the charge is in substitution for a charge given before the specified period.

(2) Unless the contrary is proved, a company giving a charge within the restricted period is presumed to have been unable to pay its due debts immediately after giving the charge.

(3) Subsection (1A)(b) does not apply to the extent that—

(a) the amount secured by the substituted charge exceeds the amount secured by the existing charge; or

(b) the value of the property subject to the substituted charge at the date of the substitution exceeds the value of the property subject to the existing charge at that date.

(4) Nothing in subsection (1) applies to a charge given by a company that secures the unpaid purchase price of property, whether or not the charge is given over that property, if the instrument creating the charge is executed not later than 30 days after the sale of the property or, in the case of the sale of an estate or interest in land, not later than 30 days after the final settlement of the sale.

(5) For the purposes of subsection (1A)(a) and subsection (4), where any charge was given by the company within the period specified in subsection (1), all payments received by the grantee of the charge after it was given shall be deemed to have been appropriated so far as may be necessary—

(a) towards repayment of money actually advanced or paid by the grantee to the company on or after the giving of the charge; or

(b) towards payment of the actual price or value of property sold by the grantee to the company on or after the giving of the charge; or

(c) towards payment of any other liability of the company to the grantee in respect of any other valuable consideration given in good faith on or after the giving of the charge.

(6) For the purposes of subsection (1), **specified period** means—

(a) the period of 2 years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date on which, and at the time at which, the order of the court was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

(7) For the purposes of subsection (2), **restricted period** means—

(a) the period of 6 months before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date on which, and at the time at which, the order of the court was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 6 months before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

294 Procedure for setting aside transactions and charges

(1) A liquidator who wishes to set aside a transaction or charge that is voidable under section 292 or 293 must—

(a) file a notice with the court that meets the requirements set out in subsection (2); and

(b) serve the notice as soon as practicable on—

(i) the other party to the transaction or the charge holder, as the case may be; and

(ii) any other party from whom the liquidator intends to recover.

(2) The liquidator’s notice must—

(a) be in writing; and

(b) state the liquidator’s postal, email, and street addresses; and

(c) specify the transaction or charge to be set aside; and

(d) describe the property or state the amount that the liquidator wishes to recover; and

(e) state that the person named in the notice may object to the transaction or charge being set aside by sending to the liquidator a written notice of objection that is received by the liquidator at his or her postal, email, or street address within 20 working days after the liquidator's notice has been served on that person; and
(f) state that the written notice of objection must contain full particulars of the reasons for objecting and must identify any documents that evidence or substantiate the reasons for objecting; and
(g) state that the transaction or charge will be set aside as against the person named in the notice if that person does not object; and
(h) state that if the person named in the notice does object, the liquidator may apply to the court for the transaction or charge to be set aside.

(3) The transaction or charge is automatically set aside as against the person on whom the liquidator has served the liquidator's notice, if that person has not objected by sending to the liquidator a written notice of objection that is received by the liquidator at his or her postal, email, or street address within 20 working days after the liquidator's notice has been served on that person.

(4) The notice of objection must contain full particulars of the reasons for objecting and must identify documents that evidence or substantiate the reasons for objecting.

(5) A transaction or charge that is not automatically set aside may still be set aside by the court on the liquidator's application.

295 Other orders

If a transaction or charge is set aside under section 294, the court may make 1 or more of the following orders:

(a) an order that a person pay to the company an amount equal to some or all of the money that the company has paid under the transaction:
(b) an order that a person transfer to the company property that the company has transferred under the transaction:
(c) an order that a person pay to the company an amount that, in the court's opinion, fairly represents some or all of the benefits that the person has received because of the transaction:
(d) an order that a person transfer to the company property that, in the court's opinion, fairly represents the application of either or both of the following:
 (i) money that the company has paid under the transaction:
 (ii) proceeds of property that the company has transferred under the transaction:
(e) an order releasing, in whole or in part, a charge given by the company:
(f) an order requiring security to be given for the discharge of an order made under this section:
(g) an order specifying the extent to which a person affected by the setting aside of a transaction or by an order made under this section is entitled to claim as a creditor in the liquidation.

296 Additional provisions relating to setting aside transactions and charges

(1) The setting aside of a transaction or an order made under section 295 does not affect the title or interest of a person in property which that person has acquired—

(a) from a person other than the company; and
(b) for valuable consideration; and
(c) without knowledge of the circumstances under which the property was acquired from the company.

(2) The setting aside of a charge or an order made under section 295 does not affect the title or interest of a person in property which that person has acquired—

(a) as the result of the exercise of a power of sale by the grantee of the charge; and

(b) for valuable consideration; and

(c) without knowledge of the circumstances relating to the giving of the charge.

(3) A court must not order the recovery of property of a company (or its equivalent value) by a liquidator, whether under this Act, any other enactment, or in law or in equity, if the person from whom recovery is sought (**A**) proves that when A received the property—

(a) A acted in good faith; and

(b) a reasonable person in A’s position would not have suspected, and A did not have reasonable grounds for suspecting, that the company was, or would become, insolvent; and

(c) A gave value for the property or altered A’s position in the reasonably held belief that the transfer of the property to A was valid and would not be set aside.

(4) Nothing in the Land Transfer Act 1952 restricts the operation of this section or sections 292 to 295.

Recovery in other cases

297 Transactions at undervalue

(1) Under subsection (2) the liquidator may recover from a person (**X**) the amount **C** in the formula A − B = C, where—

(a) **A** is the value that X received from a company under a transaction to which the company was or is a party; and

(b) **B** is the value (if any) that the company received from X under the transaction.

(2) The liquidator may recover the difference in value (that is, C in the formula in subsection (1)) from X if—

(a) the company entered into the transaction within the specified period; and

(b) either—

(i) the company was unable to pay its due debts when it entered into the transaction; or

(ii) the company became unable to pay its due debts as a result of entering into the transaction.

(3) For the purposes of this section,—

(a) **transaction** has the same meaning as in section 292(3):

(b) **specified period** means—

(i) the period of 2 years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(ii) in the case of a company that was put into liquidation by the court, the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date on which, and at the time at which, the order of the court was made; and

(iii) if—

(A) an application was made to the court to put a company into liquidation; and

(B) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 2 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

298 Transactions for inadequate or excessive consideration with directors and certain other persons

(1) Where, within the specified period, a company has acquired a business or property from, or the services of,—

(a) a person who was, at the time of the acquisition, a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(b) a person, or a relative of a person, who, at the time of the acquisition, had control of the company; or

(c) another company that was, at the time of the acquisition, controlled by a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(d) another company that was, at the time of the acquisition, a related company,—

the liquidator may recover from the person, relative, company, or related company, as the case may be, any amount by which the value of the consideration given for the acquisition of the business, property, or services exceeded the value of the business, property, or services at the time of the acquisition.

(2) Where, within the specified period, a company has disposed of a business or property, or provided services, or issued shares, to—

(a) a person who was, at the time of the disposition, provision, or issue, a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(b) a person, or a relative of a person, who, at the time of the disposition, provision, or issue, had control of the company; or

(c) another company that was, at the time of the disposition, provision, or issue, controlled by a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(d) another company that, at the time of the disposition, provision, or issue, was a related company,—

the liquidator may recover from the person, relative, company, or related company, as the case may be, any amount by which the value of the business, property, or services, or the value of the shares, at the time of the disposition, provision, or issue exceeded the value of any consideration received by the company.

(3) For the purposes of this section,—

(a) the value of a business or property includes the value of any goodwill attaching to the business or property; and

(b) the provisions of section 7 apply with such modifications as may be necessary to determine control of a company.

(4) For the purposes of subsections (1) and (2), **specified period** means—

(a) the period of 3 years before the date of commencement of the liquidation together with the period commencing on that date and ending at the time at which the liquidator is appointed; and

(b) in the case of a company that was put into liquidation by the court, the period of 3 years before the making of the application to the court together with the period commencing on the date of the making of the application and ending on the date on which, and at the time at which, the order of the court was made; and

(c) if—

(i) an application was made to the court to put a company into liquidation; and

(ii) after the making of the application to the court a liquidator was appointed under paragraph (a) or paragraph (b) of section 241(2),—

the period of 3 years before the making of the application to the court together with the period commencing on the date of the making of that application and ending on the date and at the time of the commencement of the liquidation.

299 Court may set aside certain securities and charges

(1) Subject to subsection (2), if a company that is in liquidation is unable to meet all its debts, the court, on the application of the liquidator, may order that a security or charge, or part of it, created by the company over any of its property or undertaking in favour of—

(a) a person who was, at the time the security or charge was created, a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(b) a person, or a relative of a person, who, at the time when the security or charge was created, had control of the company; or

(c) another company that was, when the security or charge was created, controlled by a director of the company, or a nominee or relative of or a trustee for, or a trustee for a relative of, a director of the company; or

(d) another company, that at the time when the security or charge was created, was a related company,—

shall, so far as any security on the property or undertaking is conferred, be set aside as against the liquidator of the company, if the court considers that, having regard to the circumstances in which the security or charge was created, the conduct of the person, relative, company, or related company, as the case may be, in relation to the affairs of the company, and any other relevant circumstances, it is just and equitable to make the order.

(2) Subsection (1) does not apply to a security or charge that has been transferred by the person in whose favour it was originally created and has been purchased by another person (whether or not from the first-mentioned person) if,—

(a) at the time of the purchase, the purchaser was not a person specified in any of paragraphs (a) to (d) of that subsection; and

(b) the purchase was made in good faith and for valuable consideration.

(3) The court may make such other orders as it thinks proper for the purpose of giving effect to an order under this section.

(4) Nothing in the Land Transfer Act 1952 restricts the operation of this section.

(5) The provisions of section 7 apply with such modifications as may be necessary to determine control of a company.

300 Liability if proper accounting records not kept

(1) Subject to subsection (2), if—

(a) a company that is in liquidation and is unable to pay all its debts has failed to comply with—

(i) section 194 (which relates to the keeping of accounting records); or

(ii) section 201 or 202 (which relates to the preparation of financial statements or group financial statements) or any other enactment that requires the company to prepare financial statements or group financial statements; and

(b) the court considers that—

(i) the failure to comply has contributed to the company's inability to pay all its debts, or has resulted in substantial uncertainty as to the assets and liabilities of the company, or has substantially impeded the orderly liquidation; or

(ii) for any other reason it is proper to make a declaration under this section,—

the court, on the application of the liquidator, may, if it thinks it proper to do so, declare that any 1 or more of the directors and former directors of the company is, or are, personally responsible, without limitation of liability, for all or any part of the debts and other liabilities of the company as the court may direct.

(2) The court must not make a declaration under subsection (1) in relation to a person if the court considers that the person—

(a) took all reasonable steps to secure compliance by the company with the applicable provision referred to in paragraph (a) of that subsection; or

(b) had reasonable grounds to believe and did believe that a competent and reliable person was charged with the duty of seeing that that provision was complied with and was in a position to discharge that duty.

(3) The court may give any direction it thinks fit for the purpose of giving effect to the declaration.

(4) The court may make a declaration under this section even though the person concerned is liable to be convicted of an offence.

(5) An order under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.

301 Power of court to require persons to repay money or return property

(1) If, in the course of the liquidation of a company, it appears to the court that a person who has taken part in the formation or promotion of the company, or a past or present director, manager, administrator, liquidator, or receiver of the company, has misapplied, or retained, or become liable or accountable for, money or property of the company, or been guilty of negligence, default, or breach of duty or trust in relation to the company, the court may, on the application of the liquidator or a creditor or shareholder,—

(a) inquire into the conduct of the promoter, director, manager, administrator, liquidator, or receiver; and

(b) order that person—

(i) to repay or restore the money or property or any part of it with interest at a rate the court thinks just; or

(ii) to contribute such sum to the assets of the company by way of compensation as the court thinks just; or

(c) where the application is made by a creditor, order that person to pay or transfer the money or property or any part of it with interest at a rate the court thinks just to the creditor.

(2) This section has effect even though the conduct may constitute an offence.

(3) An order for payment of money under this section is deemed to be a final judgment within the meaning of section 17(1)(a) of the Insolvency Act 2006.

(4) In making an order under subsection (1) against a past or present director, the court must, where relevant, take into account any action that person took for the appointment of an administrator to the company under Part 15A.

Annex 4: Voidable transactions law over the last 25 years

Voidable transactions law under the Companies Act 1955

1. Under s 309(1) of Companies Act 1955 a payment made by a company to a creditor within a two-year period prior to liquidation was voidable by the liquidator if it was made "with a view to giving that creditor… a preference over the other creditors". The test required the debtor company to intend to prefer the recipient.

2. A defence was available under s 311A(7) of the 1955 Act where the recipient:

   - had received it in good faith;
   - altered its position in the reasonable held belief that the payment was validly made and not be set aside; and
   - the court considered it inequitable to order recovery, in part or in full.

The Law Commission's proposed reforms to the regime in the 1955 Act

3. In June 1989 the Law Commission recommended reform of the regime in the 1955 Act. In respect of the voidable transactions regime the Commission stated:

> The final innovation is that voidable transactions are dealt with differently. The focus of the present, when the creditor receives payment in preference to others, is on the intention of the debtor company. This means that in circumstances where a creditor is preferred through no voluntary action by the debtor, for example, where a creditor is able to coerce the debtor, the transaction cannot be attacked. This leads to the unsatisfactory situation where creditors may be treated differently according to the quirks of their circumstances. The purpose of a voidable transaction regime is to avoid this, yet the present law permits it. Our proposals, which are drawn from both the Australian Law Reform Commission's Report and the submissions of New Zealand Society of Accountants, set out a test which is more straightforward to apply.[87]

4. The Commission proposed that a transfer of a company's property would be voidable if:

   - it related to an antecedent debt;
   - was made while the company was insolvent and within a year prior to liquidation; and
   - enabled the creditor to receive more than it would have received in a liquidation.

5. The Commission stated that its proposed approach would give emphasis on the effect of the transfer. It noted that any system that creates a regime rendering some transactions void has to choose between competing interests, and in some cases a measure of commercial certainty needs to be sacrificed in favour of fairness to all creditors.

6. The draft Companies Act included in that report maintained its focus on the effects of the payment but introduced an 'ordinary course of business' exception.[88] The Draft Companies Act contained in a subsequent report by the Law Commission included the ordinary course of business exception but also provided a defence:

   - where the creditor had acted in good faith and altered it position in the reasonably held belief that the payment was valid and would not be set aside; and
   - the court considered it inequitable to order recovery, in part or in full.[89]

[87] Law Commission, *Company Law Reform Restatement*, Report No. 9, June 1989, para 649.
[88] ibid, s 225(2)(b), page 317.
[89] Law Commission, *Company Law Reform: Transition and Revision*, Report No. 16, s 225.

The Companies Act 1993 prior to 2007

7. A voidable transaction, as enacted in 1993, was defined as follows:

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(2) A transaction by a company is voidable on the application of the liquidator if the transaction –
- (a) was made –
  - (i) at a time when the company was unable to pay its due debts; and
  - (ii) within the specified period; and
- (b) enabled another person to receive more towards satisfaction of a debt than the person would otherwise have received or be likely to have received in liquidation –

unless the transaction took place in the ordinary course of business.

8. The defence under s 296(3) of the 1993 Act prior to 2007 was as follows:

(3) Recovery by the liquidator of property or its equivalent value, whether under section 295 of this Act or any other section of this Act, or under any other enactment, or in equity or otherwise, may be denied wholly or in part if –

- (a) The person from whom recovery is sought received the property in good faith and has altered his or her position in the reasonably held belief that the transfer to that person was validly made and would not be set aside; and

- (b) In the opinion of the Court, it is inequitable to order recovery or recovery or recover in full.

9. Under s 296(3) the simple receipt of a payment by a creditor was insufficient as a defence. The creditor had to also have altered their position. The 1993 Act therefore provided two mechanisms by which a creditor could avoid paying back a payment to the liquidator:

- by establishing that the challenged payment was made in the ordinary course of business (which gave relief as of right); and

- by recourse to the defence under s 296(3) (which gave discretionary relief).

10. The 'ordinary course of business' exception was introduced in New Zealand just as Australia had abandoned it. The exception subsequently proved difficult to apply and became one of the most heavily litigated areas under the 1993 Act.

The 2007 reforms

11. Consideration of reforms to the voidable transactions regime in the 1993 Act commenced in 1999 when the Government agreed to review corporate and personal insolvency law. Following several rounds of public consultation, including the release of an exposure draft, the Insolvency Law Reform Bill was introduced into the House in 2005, enacted in 2006 and came into force in 2007.

12. One of the goals was to reduce uncertainty regarding certain key tests under the voidable transactions regime and adopting a defence for creditors that focused more objectively on the knowledge of creditors that had transacted with the debtor. It included two main changes.

13. First, the 'ordinary course of business' exception under s 292 was replaced with a test similar to the Australian 'continuing business relationship' test. New Zealand law relating to the continuing business relationship test is discussed in paragraphs 105-110 of this report.

14. Second, the Bill also replaced a defence under s 293(3) with a new defence that was intended to have the same effect as s 588FG(2) of the Australian Corporations Act 2001. However, the wording under s 296(3) was not exactly the same as s 588FG(2).

15. The defence in Australia under s 588FG(2) requires the creditor to prove that they:

- had received the payment in good faith;
- had no reasonable grounds for suspecting that the debtor company was or would become insolvent; and
- had provided valuable consideration under the transaction or changed their position in reliance on the transaction.

16. The third limb of s 296(3) was worded slightly differently to the Australian provision. "Gave value" was used, not "provided valuable consideration". The use of "gave value" resulted in a series of court cases providing conflicting authority on whether the creditor must have given value subsequent to the impugned transaction, or whether value given prior to the impugned transaction was sufficient to fall with the defence.

17. The New Zealand courts initially interpreted the provision to mean that value had to be given at the time of or after the voidable payment. This was contrary to the interpretation of the Australian provision by their courts, which allowed creditors who gave value prior to the voidable payment to rely on the defence. This interpretation meant that in practice creditors would rarely be able to rely on the defence.

18. The Supreme Court decision in *Allied Concrete* has settled the law in New Zealand in relation to the defence in s 296(3). The Supreme Court found that the New Zealand Parliament's intention was to align New Zealand's defence with that of Australia's. The differences in the relevant provisions were minor and did not affect the policy decision to interpret the New Zealand provisions consistently with Australia's. A creditor will be taken to have provided value in satisfaction of the third limb regardless of whether the value was provided before, at the time of, or after the voidable payment.

Annex 5: Voidable transactions – Clawback periods in other jurisdictions

Jurisdiction	Transaction Type	Clawback Period	Provisions
Australia Division 2 of Part 5.7B of the Corporations Act 2001 (Cth)	Unfair preferences	During the 6 months ending on the relation-back day, or after that day but on or before the day the liquidation began	ss 588FA & FE(2)
	Unfair preferences with a related entity	During the 4 years ending on the relation-back day	ss 588FA & FE(4)
	Unfair preferences entered into for the purpose of defeating creditors	During the period 10 years before the relation-back day to the date of liquidation	s 588FE(5)
	Uncommercial transactions	During the 2 years ending on the relation-back day	s 588FB & FE(3)
	Uncommercial transactions with a related entity	During the 4 years ending on the relation-back day	s 588FB & FE(4)
	Uncommercial transaction entered into for the purpose of defeating creditors	During the period 10 years before the relation-back day to the date of liquidation	s 588FE(5)
	Uncommercial transactions in a liquidation that arises out of a voluntary administration or deed of company arrangement	During the period from the relation-back day to the date of liquidation	s 588FE(2A)-(2B)
	Unfair loans	Any time on the day of or before the liquidation began	s 588FE(6)
	Unreasonable director-related transactions	During the 4 years ending on the relation-back day or on or before the day when the liquidation began	s 588FE(6)(a)
	Circulating security interests	During the 6 months ending on the relation-back day or after that day but before the day when the winding up began	s 588FJ(1)(b)
England & Wales Insolvency Act 1986	Transaction at undervalue	At a time in the period of 2 years ending with the onset of insolvency	ss 238 & 240(1)(a)
	Preference – person not connected with the company	At a time in the period of 6 months ending with the onset of insolvency	ss 239 & 240(1)(b)

Jurisdiction	Transaction Type	Clawback Period	Provisions
	Preference to a person connected with the company (otherwise than by reason only of being its employee)	At a time in the period of 2 years ending with the onset of insolvency	ss 239 & 240(1)(a)
	Transaction at undervalue	At a time in the period of 2 years ending with the onset of insolvency	ss 239 & 240(1)(a)
	Extortionate credit transactions	At a time in the period of 3 years ending with the day that the company entered administration or went into liquidation	s 244(2)
	Transactions defrauding creditors	No time limit	ss 423 & 425
England, Wales & Scotland Insolvency Act 1986	Avoidance of certain floating charges created in favour of a person connected with the company	At a time in the period of 2 years ending with the onset of insolvency (insolvent transaction not required)	s 245(3)(a)
	Avoidance of certain floating charges created in favour of any other person	At a time in the period of 12 months ending with the onset of insolvency	s 245(3)(b)
Scotland Insolvency Act 1986	Unfair preference	Not earlier than 6 months before the commencement of the winding up of the company or the company enters administration	s 243(1)
	Gratuitous alienation – a person who is an associate	Not earlier than 5 years before the commencement of the winding up of the company or the company enters administration	s 242(3)(a)
	Gratuitous alienation – any other person	Not earlier than 2 years before the commencement of the winding up of the company or the company enters administration	s 242(3)(b)
Canada Bankruptcy and Insolvency Act 1985 Companies' Creditors Arrangements Act 1985	Preference – unrelated party	Within 3 months of the initial bankruptcy event (or the date proceedings were commenced under the CCA Act)	s 95(1)(a) BIA
	Preference – related party	Within 12 months of the initial bankruptcy event (or the date proceedings were commenced under the CCA Act)	s 95(1)(b) BIA
	Transaction at undervalue – unrelated party	Within 12 months of the commencement of the bankruptcy	s 96(1)(a)(i) BIA

Jurisdiction	Transaction Type	Clawback Period	Provisions
		proceedings	
	Transaction at undervalue – related party	Within 5 years of the commencement of the bankruptcy proceedings	s 96(1)(b)(ii) BIA
United States[90] Bankruptcy Reform Act of 1978 (Bankruptcy Code)	Preference – non-insider	On or within 90 days of filing the petition	§ 547(b)(4)(A)
	Preference – insider	On or within 1 year of filing the petition	§ 547(b)(4)(B)
	Fraudulent transfer	On or within 2 years of filing the petition	§ 548(a)(1)

[90] Voidable transactions are also governed by state laws in the United States. The National Conference of Commissioners on Uniform State Laws has produced model statutes. The main purpose is to provide a creditor with the means to reach assets a debtor has transferred to another person to keep them from being used to satisfy a debt. The first model statute, the Uniform Fraudulent Conveyance Act, was adopted in 1918. It was replaced in 1984 by the Uniform Fraudulent Transfer Act (UFTA). The latest version, the Uniform Voidable Transactions Act, was adopted in 2014. It renamed and amended the UFTA. The model law has been adopted by 44 states and endorsed by the American Bar Association.
See Kenneth C. Kettering, 'The Uniform Voidable Transactions Act; or the 2014 Amendments to the Uniform Fraudulent Transfer Act', *Business Lawyer*, 70:777-834, 2015; and *Legislative Fact Sheet – Fraudulent Transfer Act – now known as Uniform Voidable Transactions Act*, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Fraudulent%20Transfer%20Act%20-%20now%20known%20as%20Voidable%20Transactions%20Act.

Annex 6: Definitions of 'related creditor' and 'related entity'

Section 245A(3) of the Companies Act
In this section,—

related creditor means a creditor who is a related entity of the company in liquidation.

related entity means, in relation to the company in liquidation,—

(a) a promoter; or
(b) a relative or spouse of a promoter; or
(c) a relative of a spouse of a promoter; or
(d) a director or shareholder; or
(e) a relative or spouse of a director or shareholder; or
(f) a relative of a spouse of a director or shareholder; or
(g) a related company; or
(h) a beneficiary under a trust of which the company in liquidation is or has at any time been a trustee; or
(i) a relative or spouse of that beneficiary; or
(j) a relative of a spouse of that beneficiary; or
(k) a company one of whose directors is also a director of the company in liquidation; or
(l) a trustee of a trust under which a person (**A**) is a beneficiary, if A is a related entity of the company in liquidation under this subsection.

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