6 October 2016

INSOLVENCY MANAGEMENT

Ministry of Business,
Innovation & Employment
Wellington

By email: Corporate.Law@mbie.govt.nz

Submission on: Review of Corporate Insolvency Law Report No 1
Insolvency Practitioner Regulation and Voluntary Liquidations

I am making submissions on behalf of the directors of Insolvency Management Ltd.

We are a firm of insolvency practitioners who specialise in liquidations both voluntary and through Court appointments. The three directors of the firm have 80 years of insolvency experience between them and there is a mix of accounting and legal expertise within the firm.

I have not made comments on all the points provided for in the submission paper by the panel, so have not followed your "Questions to submitters" fully. I have detailed areas which I see as being of importance to provide further comments for the Ministry to review.

1 Regulatory Body

The authors of the NZ Institute of Chartered Accountants and Insol NZ consultation document dated June 2013 on Insolvency Practitioner Regulation have detailed many aspects of a formal licensing regime for insolvency practitioners. It would appear that the panel in relation to the current submission document are in agreement with many aspects of this paper.

In a Memorandum of Understanding dated 1st December 2014 between Restructuring Insolvency and Turnaround Association of New Zealand Incorporated ("RITANZ") (the reincarnation of INSOL NZ) and New Zealand Institute of Chartered Accountants at:

- 2.3 "Funds: NZICA acknowledges that it is holding approximately $300,000 in funds…. (Insol Funds)…NZICA agrees to discharge all unpaid expenses of INSOL New Zealand out of the Insol Funds, and then transfer the balance of the Insol Funds to RITANZ…"

3. Joint Initiatives

- 3.1.(d) "engage with government with a view to aligning the regulation of insolvency practitioners on terms similar to those being pursued under this agreement"

Although RITANZ is an incorporated society, it appears to have been initially funded by NZICA and its membership is subject to the oversight of NZICA, now known as the Chartered Accountants Australia and New Zealand (CAANZ).

It is the writers understanding that INSOL NZ had some 350 members prior to its dissolution and that RITANZ now has some 94 members.

It is the writers' opinion that if a regulatory body is to be instigated in the role of the regulation of insolvency practitioners then a completely independent body should be incorporated. The purpose of this is to avoid any potential conflict of interest situations between the competing professional bodies or the dominant professional body having to greater an influence on the smaller professional body.

It would appear that the panel are recommending a co-regulation model between government and a modification of the CAANZ/RITANZ accreditation system already in place, so this system becomes the "frontline regulation system".

Given these findings I believe that it would have been prudent for members of the submission panel who are also members of CAANZ and RITANZ to declare their interest in the submission paper and also those members of the panel whose firms sponsor RITANZ to declare that interest.

2 Remove the ability to appoint a liquidator after service of liquidation application

I find it difficult to follow the review panel's submissions on this point.

The panel members use very emotive language in support for this concept in the paper. Such words as:

- "This provides the opportunity to appoint a debtor-friendly, incompetent or dishonest liquidator."

The panel appear to be of the opinion that by having this additional restriction on appointing a liquidator that it :

- "....will be of more benefit to the creditors as a whole as more of the assets of the company will remain..."

The panel further state that only the petitioning creditor can then approve the appointment of a liquidator after the service of liquidation proceedings.

The panel will be aware that the majority of Court appointed liquidations are at the petition of the Commissioner of Inland Revenue. The panel's submission is that the creditor (eg IRD) who has served the liquidation proceedings on a company would then be required to approve the liquidator appointed by the company after the date of service.

In the writers opinion it would therefore have been prudent for members of the panel (or where it is principals of their firms) who undertake court appointed liquidations, where the Commissioner of Inland Revenue is the petitioning creditor, to declare that interest.

What the panel is suggesting is that effectively the petitioning creditor should have the power to dictate who the liquidator of a company should be prior to the Courts judgment. In the writers opinion this is an unworkable concept in many aspects as:

- the panel are elevating the petitioning creditor to the status of the Court, as to who appoints liquidators or denies their appointment

- a protection is already put into the legislation (s241AA Companies Act 1993) in that after service of liquidation proceedings, a company has within 10 working days to appoint a liquidator and such appointment maybe challenged by the petitioning creditor by an application to the Court.

- what would happen if the petitioning creditor does not approve the liquidator to be appointed by the company directors or shareholders? Does the petitioning creditor then suggest to the company, what liquidator that it would agree to be appointed? What if the company cannot agree as to the liquidator with the petitioning creditor? The company would be in "limbo" until the application to liquidate was heard by the Court. The process from serving the liquidation proceedings until the hearing can be several months. An insolvent company could quickly lose value in that time, and are the directors to be exposed to the risk of breaching their directors' duties during this period?

In the writer's opinion, the current system as it stands balances the rights of the shareholders and directors of a company to make commercial decisions in relation to the company and those of creditors pursuing debt owed to them by those companies.

It should also be noted that a liquidator can resign and appoint another liquidator as their replacement at any time during liquidation and that creditors can also vote to change a liquidator at the first meeting of creditors.

3 Avoid transfers of assets after service of the liquidation application

The panel state that:

- "At present there is no restriction on the transfer of a company's assets once a liquidation application has been filed. We consider there should be. In our experience, the liquidation application is often the signal for a rapid transfer of assets, often at undervalue or no value, by shareholders prior to the appointment of a liquidator...."

As per point 2 above the panel use emotive language to describe this potential harm. There is no actual evidence provided as to what is "**often** the signal for a rapid transfer of assets". There is no quantitative analysis of this broad brush statement except in the panels "experience". (emphasis added)

The Companies Act 1993 has various provisions which can be enacted by a liquidator to claw back assets or their value thereof. These statutory provisions can be invoked by the liquidator or the alleged impugned transaction can be settled by negotiation with the liquidator, resulting in funds or assets being returned to the company.

The panel are suggesting further diminishing the powers and responsibilities of directors in relation to a company. As the panel will be aware a number of liquidation applications although filed in court and served upon the debtor company do not actually end in liquidation of that company. So for those companies in this position, this recommendation places further restrictions on the directors of the company.

In the writers opinion there are currently sufficient safeguards contained within the Companies Act such as the appointment of an interim liquidator, director duties provisions and claw back provisions

to deal with this matter without further legislative intervention. There are also further civil remedies which may be available to the creditor.

4 Panels Use of Emotive Language throughout the Submission

The panel at times use very emotive language to describe insolvency practitioners. But provide little in the way of quantitative analysis to support the use of that language.

Such examples include:

- "Unfortunately too many providers of insolvency services fall well short of the standards of integrity and skill that the New Zealand public is entitled to expect."
- There are self-interested practitioners who overcharge for their services or carry out unnecessary work in order to obtain larger fees.
- There are "debtor-friendly" liquidators who fail to comply with their statutory duty...
- This problem is particularly evident in small to medium sized companies
- This also means that all insolvency practitioners, not just dishonest and grossly incompetent ones, are not sufficiently accountable for negligence under current legal settings
- The problems with the status quo can be broadly categorised as relating to unprofessional conduct and incompetence
- It therefore seems to us that the misuse of voluntary liquidations is perpetrated because the actions giving rise to the voluntary liquidation are not always investigated or investigated fully by the insolvency practitioner who may be debtor friendly, incompetent or dishonest...
- ...a significant minority take advantage of weaknesses in the system to act in their self-interest, ignore their statutory duties, harm the interests of creditors and damage the integrity of the corporate insolvency system...
- We do not regard the status quo as a viable option, given the serious problems outlined above"

In the writers opinion the impression an outside observer would get from the reading the panel's submissions is that there is regular and systematic unprofessional conduct being practised by insolvency practitioners in New Zealand.

The panel state that "... it is very difficult to meet the statutory requirements for obtaining a practitioner banning order from the Court..." but further in their submission they provide great detail of those practitioners that have been dealt with by the Courts for incompetence, lack of professionalism or criminality.

What is not stated by the panel in highlighting these insolvency practitioners who are wrongdoers, is what percentage of insolvency assignments are undertaken each year (or those that can be monitored) and those practitioners that fail to adhere to the legal standards of practice. That is, how do the panel ascertain that there is a "significant minority" behaving in this less than professional

standard? What is the measuring stick that allows statements of this nature be directed against the insolvency profession as whole?

It would appear that the panel are highlighting the extreme cases of unprofessional conduct of a few insolvency practitioners whilst minimising the majority of practitioners who year on end deal with insolvencies in a professional and appropriate manner.

In a Ministry of Business, Innovation and Employment ("MBIE") paper titled "Insolvency Practitioners Regulatory Impact Statement" it is stated:

- "Given the small size of the insolvency industry and the ***small number of substandard practitioners*** operating in the industry, the negative licensing regime will provide the most cost-effective solution that is appropriate and proportionate to the problem and size of the insolvency industry. (Emphasis added)

- The ***small number of practitioners that are substandard*** will be dealt with expediently by the Registrar of Companies, which would mean that some of these practitioners would be, in extreme cases, prohibited from taking up further appointments...." (Emphasis added)

It is difficult to ascertain how the panels "significant minority" and "too many providers of insolvency services fall well short of the standards of integrity and skill" align with the MBIE's "small number of substandard practitioners". The submission panel and MBIE government officials appear to be viewing the insolvency profession from differing perspectives.

Any profession will always have its miscreants regardless of the regulations and codes of conduct.

Whilst it is easy to make generalised statements which depreciate insolvency practitioners, there appears to be no real analysis of the actual issues, except for in the panels "experience". In the writers opinion a more detailed and quantitative approach to the submissions would be appropriate before such wide ranging and disparaging statements regarding insolvency practitioners are detailed in the submissions.

5 Conclusions on Accountability through the Court System

The panel have pointed out that the Court has insufficient powers to deal with practitioners who have breached their duties.

The panel have highlighted these shortcomings in the legislation.

Rather than disturb the whole insolvency system by the various proposals submitted by the panel, it may be more prudent to take incremental steps to address the issues that concern the panel. One of the first incremental steps may be to enhance the power of the Court (in its supervisory capacity of insolvency practitioners) as suggested by the panel in their submission.

6 The absence of mandatory professional and ethical standards

The writer does not have an issue of a professional organisation being available for insolvency practitioners to participate in, but I would be opposed to one professional body controlling the

whole of the insolvency profession, whereby that insolvency organisation is strongly aligned to another professional organisation which may at times have a differing agenda for its members.

Although traditionally insolvency has been dominated by accountants, that mix is starting to slowly change as the insolvency profession develops. There are now a number of non-accounting professionals in the insolvency profession who bring a wide range of skills that may not be solely accounting based.

As previously detailed in this correspondence NZICA (or CAANZ as the new organisation is known) would appear to have a financial interest, as well as a strong regulatory interest in RITANZ. The panel are of the view that:

- "We are recommending co-regulation mainly because much of the "regulatory infrastructure" already exists. It should be relatively easy to modify CAANZ/RITANZ accreditation to become a frontline regulation system".

The very organisation (CAANZ) that would appear to support the view that insolvency professionals should be regulated under the one professional body, have for their own accounting profession not deemed it necessary. There is an agreed separation of chartered accountants from accountants, whereby an individual can practice as an accountant and is not required to be a member of CAANZ.

In the accountants' situation, the market decides whether they wish to have an accredited chartered accountant as their accountant or non-accredited accountant as their accountant.

Could an insolvency practitioner be in the same position as an accountant regarding accreditation to a professional organisation?

The market can then decide as to what insolvency practitioner they wish to engage, either the accredited or non-accredited practitioner. It is already noted that some practitioners are now advertising there services as a RITANZ accredited insolvency practitioner.

7 The continuing business relationship provision

The panel state under this heading:

- "The more experienced and capable the firm or practitioner, the higher the likelihood that the firm or practitioner will have a "continuing business relationship" with the trading banks. The existing rule therefore excludes the very practitioners who are the most suitable for appointment. In some cases another practitioner will be appointed simply to avoid the delay and expense."

This statement would appear to be very subjective and I would suggest that it does not stand scrutiny to the reality of the situation. The statement appears to imply that if you undertake client work for a trading bank then somehow you are of a higher quality than those insolvency practitioners who choose not to take assignments from the bank or who are not instructed by the bank.

If for example an insolvency firm declines to accept assignments from a bank to review various companies trading operations, I do not believe that this decision makes that firm any less suitable to then be the liquidator of those companies. The firm may have declined the

appointments from the bank due to a potential conflict of interest, if it were then to become the liquidator of those companies. This then would be a decision based on that firms ethical standards rather than a reflection of its level of competency.

I would refer to Re Bridgman [2016] NZHC 933 at:

- [9] "The purpose of s 280 is to ensure persons appointed have sufficient independence, competence and integrity to carry out the roles without causing risk to creditors or third parties.

- [10] An important consideration on an application such as this is whether there is a risk that the proposed administrators'/liquidators' independence and ability to carry out their tasks professionally and effectively might be compromised in the particular circumstances. The interest of the creditors are important."

It is a safeguard for creditors that this statutory provision remains in place so that ultimately the Court after hearing appropriate submissions can decide on a case by case basis whether a conflict of interest would arise or otherwise grant the application for the appellant to be appointed a liquidator or administrator.

The submission panel state that obtaining the orders for a court exemption is an unnecessary expense borne by the creditors. The practitioner though is aware of this provision but chooses to take the appointment knowing that a requirement will be to get a court order. This does not appear to be a high cost to insure that independence is maintained throughout the appointment process and it is appropriate that the guidance of the Court is sought in these situations. The practitioner is under no obligation to accept the appointment and incur the cost of seeking the court's sanction if they are not comfortable with the process.

Given the above matters outlined above, in the writer's opinion, the current statutory provision in place does not require any further amendment.

8 The professional services relationship provision

Similar to the "continuing business relationship" argument above, the oversight of the court is an important function to ensure the independence of the insolvency practitioner is maintained and I do not believe that any changes are required to be made to this provision.

The submission panel say in relation to this issue:

- "Another problem arises through section 280 (1)(ca) of the Companies Act. Unless the court orders otherwise, this section prohibits the appointment of insolvency practitioners as liquidator or administrator where they (or their firm) have provided professional services to the company within two years immediately before the commencement of the liquidation."

The panel perceive this as a problem? The question then being, a problem for whom? The Courts who have applied and interpreted this section have not seen it as a "problem" but more of a check and balance that relates to the independence of the practitioner in undertaking the insolvency assignment. As per point 7 above, ultimately the insolvency practitioner can apply to the court for an exemption from this provision.

In the writers opinion this provision balances the role of the insolvency practitioner as being independent, whilst allowing the opportunity for the practitioner and any affected parties to make appropriate submissions to the court in relation to waiving the application of the section to the practitioner. The court on a case by case basis will then give judgment as to whether it is appropriate (or not) to waive the application of this section to the practitioner.

One of the reasons the panel see this section as being a "problem" is because the ".... insolvency practitioner and investigating accountant are selected by, and appointed at the behest of, one of the biggest creditors (a bank) and not the company itself. However, they provide services to the company and so are prevented from acting as liquidators and administrators."

As was stated by the Court in the case of D & F Contracting Limited ex parte Blanchett and Fatupaito HC AK 2008-at:

- [4]- "... It is said that "there is no real conflict" for a number of reasons which are set out in counsel's memorandum. However, whether or not there is a conflict is the very issue that the Court needs to be informed on and the usual way be doing so by hearing from any potential opposing party."

- [8] However, the applicant Ms Fatupaito deposes that a possibility of a conflict of interest is "theoretical"only. She points out that PWC is a large organisation that acts for 42 of the largest 100 listed companies in New Zealand and provides other services to thousands of companies in New Zealand. Neither she nor Mr Blanchett have provided those other services with one exception. That exception is that Mr Blanchett is presently the receiver of an unrelated company, having been appointed by the Bank of New Zealand, which is one of the creditors of the company in this case.

- [9] Mr Blanchett is known to the Court as a competent and reputable practitioner in insolvency work. However, it is by no means clear that he is not subject to a potential conflict of interest which s280 was designed to avoid because of the fact that he is personally providing services to the Bank of New Zealand which is secured creditor of the company. There is a potential conflict between his duty as liquidator to be neutral and even-handed in his treatment of creditors, on the one hand, and his interests, on the other, which arise from the fact that he is receiving paid employment as a receiver from one of the creditors of the company, namely the Bank of New Zealand. I doubt that it would be appropriate to make an order absolving him from the requirements of s280, let alone on an ex parte basis."

Despite the panel's view that this statutory provision is a "problem," I would see the provision as an important check and balance in the appointment of insolvency practitioners and in the writers opinion this legislation should remain without further amendment.

Summary

The writer is not opposed to further regulation of the insolvency industry, but I do not believe a broad brush approach is required to affect a number of wide ranging changes which are largely untested in the New Zealand market.

A starting point in the writers view would be to provide the Court with more oversight of liquidators as has been pointed out by the panel in their submission.

CAANZ (or NZICA as it was then known) have introduced a voluntary regulatory system for insolvency practitioners which I believe is commendable but it should not be enforced upon all insolvency practitioners.

I would suggest that the framework for insolvency practitioners could work in a similar fashion to the accounting profession whereby you have chartered accountants aligned and governed by CAANZ and accountants per se who have no allegiance to that organisation. Ultimately the market decides as to what professional they wish to engage.

Similarly in the writer's opinion this approach which the accounting profession has adopted should first be taken into consideration when reviewing the insolvency profession.

In the writers opinion it is recommended that:

1. Members of the submission panel should be increased to encompass a wider group of insolvency practitioners if further submissions are required. Members of the panel should where appropriate declare any potential conflict of interest that may arise when formulating the submissions.

2. The Courts powers of supervision of liquidators, administrators, and receivers to be increased as per the panel's recommendations.

3. The voluntary licensing regime now in place and administered by CAANZ and RITANZ to be retained.

4. There is no enforced licensing system to be placed on all insolvency practitioners, but this to be reviewed at a later specified date in order to assess the markets response to the voluntary licensing regime.

5. The government to further review the negative licensing provisions to further prevent unsuitable candidates from taking on certain insolvency assignments.

6. The government to review existing statutory requirements, with the view of increasing the minimum disqualification criteria under the Companies and Receiverships Acts and enhancing the Registrar of Companies statutory powers to ban reprobate insolvency professionals.

7. Should a mandatory licensing system be preferred, the Australian Government Licensing system to be further reviewed or that a completely independent insolvency body be set up which is not strongly aligned to another professional body.

In the writers opinion one of the key attributes of an insolvency practitioner which the panel have not adequately referred to in their submissions is that of being independent. This independence should not just be in the assignments the insolvency practitioner undertakes but should also be reflected by the professional organisation which represents them. Also in the writers opinion an insolvency practitioner should not only be independent but should also be seen by the general public to be independent.

The writer is not condoning miscreant insolvency professionals, but I am of the opinion that the panel has not adequately provided enough evidence to support the view that there is a widespread

problem throughout the insolvency profession, given the number of appointments in a year undertaken by insolvency professionals.

There is always room for improvement within the insolvency profession (as in any profession) but I am not of the view that mandatory licensing of insolvency professionals governed by an organisation which is strongly aligned to another professional body is the answer.

I believe an incremental approach as suggested in this correspondence would be a "first step", coupled with greater regulatory powers given to the Register of Companies, the Court and a negative licensing system to be put in place would be a sufficient first step in improving the conduct of insolvency practitioners within the profession.

After a suitable period has elapsed, a further review can then be undertaken to ascertain the effect of these "first step" changes combined with the markets recognition of the voluntary licensing procedure that has been put in place by CAANZ/RITANZ.

Should you have any questions on the above matters please do not hesitate to contact the writer.

Yours faithfully

Gus Jenkins
Director
Insolvency Management Limited