Submissions on the Review of Corporate Insolvency Law

Report No. 1 of the Insolvency Working Group, on Insolvency Practitioner Regulation and Voluntary Liquidations

Introduction and general comments

PricewaterhouseCoopers (PwC) has one of New Zealand's longest established and largest Insolvency Practices.

Currently, PwC's New Zealand Insolvency Practice comprises four full time Partners, and three Partners who practice in the area part time. In addition PwC has approximately 50 professionally qualified full time staff employed in its Restructuring practice including six experienced Directors.

PwC operates as a national practice with seven offices spread throughout New Zealand.

PwC handles a large volume of insolvency assignments, comprising liquidations, receiverships and voluntary administrations. In addition, PwC routinely undertakes a large number of business appraisals, monitoring assignments and restructurings relating to companies and other businesses encountering financial stress. As part of its insolvency and restructuring work, PwC frequently works with New Zealand's major trading banks, Inland Revenue, the Official Assignee, the Ministry of Business, Innovation and Employment (MBIE), the Financial Markets Authority and numerous creditors and other stakeholders in relation to the assignments carried out.

Over the last three years PwC partners and directors have been appointed to in excess of 25 receiverships, and in excess of 800 liquidations. PwC is one of the three firms that Inland Revenue have approved as their nominated liquidators in Inland Revenue initiated liquidations that come before the High Court. We believe that PwC handles more formal insolvency appointments than any other firm in New Zealand.

Note that John Fisk, a PwC Partner and the Leader of PwC's National Restructuring Practice, is a member of the Insolvency Working Group (IWG) and therefore has been extensively involved in the preparation of the First Report. These submissions have been prepared independently of the IWG, and represent the views of PwC as a Firm, and are therefore independent of Mr. Fisk's role as a member of the IWG.

All PwC Partners and Directors who are active insolvency practitioners and who take appointment as receivers or liquidators are members of the Restructuring Insolvency and Turnaround Association New Zealand Incorporated (RITANZ), and are all Accredited Insolvency Practitioners (AIP's) under the RITANZ accreditation regime. PwC strongly supports the RITANZ objectives and its recently introduced AIP regime.

1. ***Do you agree with the Working Group's views on the problems with the status quo? (see paragraphs 39-77) What is the scale of harm being caused by these problems? If applicable, please describe the impact of the current insolvency practitioner regulation regime on your business.***

   PwC strongly agrees with the identified problems arising from the current regime, in particular the concerns regarding unprofessional conduct and more especially the extent of incompetence. The latter largely reflects lack of skill and experience in an area of practice that can be technically demanding (e.g. the application of rules and Court precedents to transactions at under value and voidable transactions, tracing rules in relation to voidable claims, rights of preferential creditors to debtor proceeds vis a vis a GSA holder, competing PMSI claims, etc) and requires extensive commercial judgment (e.g. decisions concerning the merits of pursuing litigation, continued trading, and the sale of a business or assets).

We are strongly of the view that the current provisions of the Companies Act 1993 (the Act) need to be amended as it continues to perpetuate the position where virtually any person over 18 years old, of sound mind, and regardless of being a convicted criminal can practice in the area of insolvency with no obligations whatsoever to adhere to any professional standards. Given the circumstances likely to give rise to insolvency work and the nature of that work, one would expect quite the opposite, in order to provide creditors, employees and other affected parties as well as the business community at large with greater confidence that business failures will be properly handled by skilled and experienced professionals in order to maximize recoveries and minimize the prospect of further loss.

As a Firm PwC has direct experience in a number of files that illustrate the sort of issues that are illustrated by the specific examples referred to in paragraphs 47 – 54 of the IWG report.

This is illustrated by one recent instance. In May 2016 the shareholders of a debtor company purported to put the company into liquidation by resolution and appoint their own preferred liquidator after Inland Revenue had filed an application to liquidate the Company in the High Court. In June 2016 the Court terminated the voluntary liquidation and appointed liquidators from PwC that were nominated by Inland Revenue. The Court noted that there was reason for independent liquidators to be appointed.

However, the shareholders then called a creditors' meeting to have their nominated liquidator reappointed again. Due to the quantum of one of the shareholders' claim as an unsecured creditor, the appointment of the shareholders' liquidator was passed at the meeting. The shareholders' liquidator had previously been convicted of offences under the Tax Administration Act 1994 but this was not a bar to him being appointed. It was only after PwC filed an application in the Court opposing the replacement liquidator's appointment that the shareholder and the replacement liquidator agreed for PwC to remain as liquidators. However, this entire process cost several thousand dollars by way of additional professional fees (including legal costs) and was a distraction to the core tasks of the ongoing administration of the liquidation.

PwC has encountered a number of similar situations.

PwC has always operated to a much higher standard than the current regime. In particular:

- PwC requires every insolvency engagement to be led by partners and directors with extensive experience.
- All insolvency engagements are staffed by professional qualified staff with appropriate experience.

- Every formal appointment involves a "four eyes approach" whereby the engagement is led by not one but two senior people, comprising at least one partner and a senior director or fellow partner so that all material actions and decisions involve concurring peer reviews.

- PwC has a system of internal quality assurance reviews where staff from other offices independently review files to ensure the Firm's quality assurance standards are being adhered to. In addition, every two years such reviews are conducted by a PwC partner from another country within PwC's global network.

- PwC requires all partners and staff to attend mandatory professional training with the time commitment far exceeding the minimum professional requirements stipulated by CAANZ.

- As noted in the general comments above, all PwC partners and directors who accept appointments as receivers or liquidators are RITANZ accredited insolvency practitioners.

In summary, PwC believes that insofar as it relates to insolvency practitioner regulation, the Act is totally inadequate. The currently proposed provisions under the Bill do not go far enough to regulate professionals, who through their work assume third party responsibilities, as well as being out of step with practice in Australia and other key common law jurisdictions.

2. *Do you agree with the listed objectives? (see paragraphs 78-81)*

PwC strongly agrees with the objectives listed in the IWG report.

Insolvency Practitioners accepting formal appointments (whether as liquidator, receiver or administrator) are acting in a fiduciary capacity. They are generally in charge of monies that will, in due course, be paid to those creditors entitled to receive funds in accordance with statutory priorities. The nature of insolvency situations means that the companies and businesses in question have generally failed, giving rise to a situation of actual or prospective loss for some or all creditors.

All of these circumstances serve to place heightened emphasis on the requirement for sound commercial judgment, professional expertise, as well as honesty and integrity on the part of the insolvency practitioner including holding and accounting for funds recovered and distributed.

The insolvency practitioner will be charging their costs against the funds available to creditors generally with a statutory preference to be paid ahead of those creditors. This places yet more emphasis on the importance of the insolvency practitioner's professionalism and integrity, so as to counter the perception (unfortunately justified by some evidence) that the insolvency practitioner, either because they are unprofessional, incompetent, or in some cases simply dishonest, will incur unnecessary and excessive cost for their own benefit, all of which will be at the expense of the distributions ultimately available to creditors.

In order to provide creditors with greater confidence that their losses will be minimized and recoveries maximized, it is important that those people appointed to recover monies on their behalf are demonstrably well qualified and experienced for the roles they carry out.

The Bill in its current form needs to be amended to raise the required standards of insolvency practitioners.

3. ***Do you generally agree that changes proposed in the Insolvency Practitioners Bill that do not relate to the registration regime proposed in that Bill along with the additional related changes proposed by the Working Group should be progressed? Please include any comments you have on one, some or all of the proposals detailed in Annex 3.***

PwC believes that section 280(1) (cb) requires amendment to remove the current prohibition on the appointment of a liquidator or administrator where that person or their firm has a professional relationship with a secured creditor of the debtor company. Often the secured creditors will include a trading bank that has a general security agreement over all the assets of the debtor company. Along with many other major providers of insolvency services, PwC provides professional services to all major trading banks in New Zealand, and is therefore in almost every case precluded from appointment without first seeking approval from the High Court pursuant to section 280. Whilst such approvals are invariably forthcoming from the High Court, the process itself adds unnecessary cost and time for no benefit.

The current provision also often results in practitioners who have the required skills, experience and resources to undertake an insolvency appointment being precluded from assignments while other practitioners who are less experienced and competent are able to undertake the insolvency without needing the Court's approval.

PwC believes that:

- Interest statements should only be included in the first report to creditors and do not need to be repeated in each subsequent 6 monthly and final report. Instead, it should only be necessary to report any new conflicts of interest and how they are being managed in subsequent reports.

- Receivers and administrators should only be obliged to report that they believe an offence has been committed where this "appears" to be the case, so that there is no positive obligation upon receivers or administrators to undertake specific investigations for this purpose. Liquidators should be subject to a higher onus, with a requirement to report when they "believe" or "consider" that an offence has been committed. PwC also agrees that absolute privilege on such reporting should be extended to administrators.

- Regardless of any other changes to the present Act, and the inclusion of a regime to regulate practitioners, a previous conviction for dishonesty must be considered as an additional disqualifying factor that should be applicable under section 280.

- The current proposed provision requiring payer and payee details be disclosed for every transaction in a liquidation in all 6 monthly and final reports is far too onerous and will add significantly to the cost of the liquidation. Inclusion of this level of detail is unlikely to add any additional benefit to creditors. This provision should be removed.

PwC believes strongly that an insolvency practitioner accepting an appointment in respect of a New Zealand company or business enterprise primarily domiciled in New Zealand should themselves be domiciled in New Zealand. There are three reasons for this:

- This approach would be consistent with the existing requirement in the Companies Act for every New Zealand company to have at least one New Zealand resident director.

- New Zealand would then have the same approach as that which prevails in Australia.

- Most importantly, it means that creditors or other affected parties who may wish to bring an action against an insolvency practitioner are better able to do so. In practice it can be prohibitively expensive to mount legal action against a party domiciled outside New Zealand. Insolvency practitioners need to be accountable for their actions, and in practice this means legal accountability via the New Zealand court system.

PwC has observed recent examples of trans tasman businesses that have failed where the New Zealand arm of the failed business has been administered by an Australian resident insolvency practitioner. In some instances this has led to what can only be described as "confusing actions" that may not have served the creditors' best interests. As a general rule PwC believes that practitioners from other jurisdictions, no matter how experienced in their home jurisdiction, will likely lack familiarity with the New Zealand insolvency regime and its statutory requirements, and for this reason alone they should not be taking New Zealand appointments.

PwC believes that creditor compromise arrangements and the involvement of professional advisors in relation thereto should be excluded from the ambit of the regulatory regime applying to insolvency practitioners.

The reason for this is that it is important to have a flexible and cost effective approach that enables companies and their creditors to reach expedient agreement in a cost effective manner on a restructuring of debt in order to enable a company to continue trading, and it should be possible to do this outside of a formal insolvency procedure.

4. *Do you agree with the proposed changes to the High Court supervision of liquidators? (see paragraphs 154-156)*

PwC agrees with the IWG's recommendations that the High Court should retain oversight of insolvency practitioners. However, there ought to be clarification of what actions (or inactions) can result in the High Court removing a liquidator. Reference to a "serious" or "material" breach of the liquidators' duties could assist with such a provision.

5. ***What are your views on the four occupational regulation options proposed by the Working Group? (see paragraphs 116-146)***

PwC strongly supports the IWG's recommended model of co-regulation for insolvency practitioners.

Reasons for this are:

- This approach is consistent with that applied to the regulation of other parts of professional practice in New Zealand.
- The RITANZ initiated AIP regime provides a comprehensive rigorous and robust model.
- Introducing Government oversight of the RITANZ AIP regime should be straightforward.
- This approach should be the most cost effective.

Refer also to the reasons and comments provided under Question 1 above.

6. ***Do you agree with the details of the co-regulation system recommended by the Working Group? (see Recommendations 3-8 on pages 3 and 4)***

PwC agrees with the IWG recommendations, subject to the following specific comments:

PwC strongly believes that only New Zealand domiciled insolvency practitioners should carry out engagements (for the reasons set out under Question 3 above). Therefore PwC considers there is no need for any government regulator or other body to license overseas-qualified practitioners who are not members of an accredited New Zealand professional body (such as the RITANZ AIP regime). Accredited New Zealand professional bodies can introduce criteria for recognising relevant overseas experience and qualifications when considering applications for membership.

PwC believes that legislation should continue to include certain minimum requirements that must be satisfied before an individual practitioner can be eligible to apply to be an AIP. We envisage the same criteria as set out by the IWG could be employed for this purpose.

7. ***Are there other feasible options to address the problems identified by the Working Group with the provision of insolvency services?***

Given our general support for the IWG recommendations that there be a proper accreditation regime for insolvency practitioners using a co-regulation model, PwC cannot readily identify any other feasible option likely to be as effective at enhancing the provision of insolvency services, and ultimately improving the confidence and perception that external stakeholders have in relation to insolvent situations and their management.

8. ***An alternative option for regulating insolvency practice would be to only require the practitioner to be a member of a professional body, such as CAANZ or RITANZ, without any oversight from an independent government regulator. Would this option provide a more cost effective model for regulating insolvency practitioners?***

For the reasons already set out above, PwC believes that a proactive approach to regulation of insolvency practitioners is required (rather than being a negative licensing regime as is proposed in the Bill). In PwC's view merely being a member of professional bodies such as CAANZ or the New Zealand Law Society is insufficient, as these organisations include many individuals who, whilst having an interest in the practice of insolvency, lack the dedicated experience and technical skills to be qualified practitioners in the area.

9. *Should insolvency services be restricted to only certain members of an accredited professional body, as opposed to all members of the accredited professional body? If so, what criteria should be applied to determine which members of the accredited professional body would be permitted to provide insolvency services?*

For the reasons set out above (refer Questions 1, 2, 5 and 8), PwC strongly believes that given the nature of insolvency engagements, practitioners need to be specifically accredited for such work, rather than merely being members of a professional body whose membership will naturally be far more diverse and generally lack the specialised skills and experience associated with insolvency engagements.

10. *How might the different options impact on competition within the insolvency services sector? How would the different options impact on the availability of insolvency services to businesses and creditors outside the main centres of New Zealand?*

We understand that RITANZ already has a substantial membership, including many practitioners from outside the main centres. A review of RITANZ membership composition and the individuals who have become AIPs should confirm that there are sufficient practitioners operating throughout New Zealand.

PwC is one of a number of New Zealand firms that has offices located throughout the country, with fully staffed provincial offices including professionals who are already themselves accredited insolvency practitioners.

11. *Do you agree that introducing a licensing regime for insolvency practitioners would reduce much of the harm raised by aspects of the voluntary liquidation process? (see paragraphs 174-178, 201)*

A proper licensing regime for insolvency practitioners is at the heart of addressing the concerns around the voluntary liquidation procedure being misused. Proper regulation of insolvency practitioners, such as would occur if all practitioners must be AIP's under the RITANZ regime will provide much greater confidence that voluntary liquidations will be carried out by properly qualified and competent professionals, who are more likely to display the requisite integrity and honesty, and who will not therefore be perceived as being debtor friendly.

The RITANZ regime also provides third parties with access to a process where complaints can be handled in an accessible and transparent manner with proper investigation and disciplinary processes to safeguard the overall integrity of the regime for the benefit of creditors and other stakeholders.

12. Do you agree that the latent defect problems in the building and construction sector are issues best solved by building and construction sector law and should not be directly addressed by changing insolvency law? (see paragraphs 179-186) If not, what would you suggest?

In responding to this question PwC notes that it has handled New Zealand's two largest failures in the building and construction sector that have occurred over the last 15 years, namely the collapse of Hartner Construction in February 2001 and the collapse of Mainzeal Construction in February 2013. In addition, we have administered a large number of smaller construction failures as well as other sector related business failures (e.g. developers, other supply chain participants etc).

PwC does not believe there is any compelling reason to introduce specific changes within the insolvency laws to cater for actual or perceived problems within the building and construction sector. To do so will inevitably lead to unnecessary complexity and the potential for inequity and disputes among creditors.

Changes have already been made to the Construction Contracts Act which are intended to better protect the position of contractors and subcontractors, particularly through the intended safeguarding of retentions. Whether this works effectively in practice remains to be seen. We note that PwC made a separate submission to MBIE on 3 June 2016 in respect of the Construction Contracts Amendment Act 2015, including specific references to potential impacts on insolvency processes. However, PwC see no need for any specific changes to the insolvency laws to cater for actual or perceived problems in this particular sector.

13. Do you agree that one, some or all of the three measures proposed by Group will address the harm of some voluntary liquidations? (see the Working paragraphs 187-200)

PwC agrees with all of the IWG's recommendations on this area.

The current 10 day window for shareholders to appoint their own liquidator after the debtor company is served with a winding up application by a creditor makes it all too easy for a debtor-friendly liquidator to be appointed over the top of the creditor's nominated liquidator when a company in insolvent. Removing the 10 day window would go a long way to addressing this problem. As suggested by the IWG, shareholders would still have the opportunity to appoint their own liquidator either at an earlier stage, such as when a statutory demand is served by a creditor and is not able to be paid, or if the petitioning creditor approves the shareholders' nominated liquidator. An additional provision PwC suggests, would be that not only should the petitioning creditor be required to approve the liquidator but also any other creditor who has filed an application in support of the petitioning creditor's application should also be required to give their approval.

Allowing the shareholders to also make an application to the Court to approve their nominated liquidator to be appointed, which is already provided for under section 241(2)(c)(iii) of the Act, gives the shareholders an opportunity to convince the Court that their nominated liquidator is sufficiently qualified, independent, and has the resources to undertake the liquidation.

PwC notes that the co-regulation model should also address the concerns around the appointment of perceived "debtor friendly" liquidators by shareholders as all liquidators would be subject to oversight and the complaints procedures that would be established by the immediate regulatory body, being RITANZ under the model recommended by the IWG.

In relation to the proposal that would prohibit the transfer of the assets of a debtor company following the service of a liquidation application, PwC considers that a blanket prohibition on such transfers could prove problematic and may prevent sales at fair value to legitimate third parties. If such a transaction occurs and the petitioning creditor considers there is a risk that the proceeds of sale may be dissipated an application can be made to appoint an interim liquidator to preserve the assets of the company under section 246 of the Act. If there is concern following the appointment of liquidators that a transfer has occurred at less than fair value or in preference of one creditor there are existing powers in section the Act to address this.

Where mischief could occur is when assets of a debtor company are transferred to a related party to allow control of the business to remain with the same parties pre and post liquidation. In those circumstances it would be appropriate to place a prohibition on the transfer of assets, but such a transfer could occur with the approval of the Court. Such approval could be granted where the Court is satisfied that the transfer is in the interests of the creditors of the Company.

14. Do you agree with the benefits of a unique identification number for directors?

PwC agrees that this will be a useful practical initiative. Consideration should also be given to such an initiative for shareholders.

15. Do you have any other comments on Report No. 1?

PwC acknowledges the extensive time and effort put in by all members of the IWG to produce their first report which presents a thorough analysis of the issues and a robust set of recommendations that PwC concurs with in the most part.

As New Zealand's largest provider of insolvency services, PwC is keenly interested in seeing a more highly regarded profession of insolvency practitioners, and believes that the concept of a co-regulated licensed insolvency practitioner regime that adopts the RITANZ Accredited Insolvency Practitioner model will go a long way to achieving this result.

PwC will continue to support the work of the IWG and MBIE in this regard.