# SUBMISSION ON;

# REVIEW OF CORPORATE INSOLVENCY LAW

By DAMIEN GRANT

Waterstone Insolvency

> [48] The creditors of a failed company are ordinarily entitled to have its affairs thoroughly investigated to learn whether it has any assets, or the liquidator any rights of recourse, that might repay them. Where a creditor, or in this case the liquidator, is prepared to fund such investigation, the Court will not lightly deny them the opportunity that it represents.
>
> Court of Appeal Grant and Khov v CP Asset Management Limited
> CA67/2013 [2013] NZCA 452

**Review of the Review**

It is always pleasing to see government engaging with business and the professions before embarking on any legislative changes and to this extent the creation of the Insolvency Working Group is an excellent idea.

When confronting the insolvency industry there are a wide number of competing interests.

Insolvency Firms

First, of course, are the insolvency firms themselves. Those at the coal-face of the profession who do the work get the complaints and deliver, or not, the results.

Insolvency firms can be broken into three general types.

*Large Accounting Firms*

The 'big four', being PWC, KPMG, Deloitte and recently EY all have active insolvency practices. In addition to seeking the lucrative receivership work PWC, KPMG and Deloitte receive a disproportionate level of liquidation appointments by being on the IRD's approved list.

*Small Insolvency Practices*

The majority of liquidations are taken by around forty small insolvency firms. Most of them have between three and fifteen staff and many of them work exclusively in the insolvency industry.

*Specialist Receivership Firms*

There is a small group of firms that specialise in receivership work and rarely if ever take liquidation work. These firms, such as McGrath Nicol and Korda Mentha, usually come out of accounting firms or are headed up by people with accounting and sometimes legal backgrounds.

The Legal Profession

Lawyers are an integral part of the insolvency industry, working both for insolvency practitioners and those who are being sued by them.

For a law firm having an active insolvency practice as a client will be a lucrative part of their practice. Large litigation files often require extensive legal advice, research and document drafting. It can be expected that a close, even symbolic, relationship will build between a lawyer and the insolvency firm they represent.

Law firms can often be an important source of work for an insolvency firm.

Lawyers who act for those dealing with litigious insolvency practitioners will not have the same level of commitment or engagement with insolvency as such engagements will be infrequent.

Creditors

The point of an insolvency is to provide a return for creditors. However, their interests are rarely aligned.

*Preferential Creditors; Staff*

Parliament has mandated that staff receive preferential treatment when it comes to being paid from the assets of an insolvency. These are often the most vulnerable victims of an insolvency and unfortunately are rarely compensated.

*Preferential Creditor; IRD for GST and PAYE*

After staff for unpaid wages, the Inland Revenue is next to be paid but only for unpaid GST and PAYE. They are an unsecured creditor for Income tax and for all interest and penalties

*Secured Creditors*

A secured creditor has a specific security over an asset or in some cases a General Security Agreement (a debenture in the old language) over the entire company. These creditors are often well placed to arrange payment and are often the only parties in an insolvency who recover some payment.

The Working Group

The working group had representatives from the big four insolvency firms, one debt collector and two lawyers who work closely with a number of insolvency practitioners, in addition to a government lawyer. In essence, there was no representatives of the smaller insolvency firms, no real participation from unsecured creditors and no one representing the interests of unpaid staff.

It can be expected, therefore, that any recommendations that come from this group, even with the best efforts to be objective, will reflect the concerns of the large accounting firms and the lawyers who serve them. This, it appears, is what has happened.

> *People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices.*
>
> *Adam Smith; The Wealth of Nations*

**Waterstone**

Waterstone was formed in 2006 by Damien Grant, the author of this submission. At the time we had no insolvency experience nor any relevant accounting or legal experience.

In short, we were exactly the type of firm that the authors of the Review of Corporate Insolvency Law wish to keep out of the industry.

Today we have thirteen staff. We have taken an innovative approach to insolvency and have employed an in-house team of lawyers who take litigation on behalf of liquidated companies. We aggressively self-fund litigation and have achieved some remarkable results for creditors and have established an excellent reputation with the courts.

**Insolvency Practitioners; Myths and Realities.**

The opening of the report makes a number of assertions that are not correct. It may be helpful to examine some of these.

Ability to practice insolvency

An underling assumption behind the drive to regulate liquidators is that it is too easy "…for individuals who do not have the required integrity, knowledge, skills and experience to become an insolvency practitioner."[1]

The evidence does not bear this out. Whilst it is true that the technical requirements for taking an appointment are very low unqualified individuals rarely take appointments and when they do it tends to be only on small cases of no consequence.

Attached to this submission is a summary prepared by the author of all of the liquidations advertised in the NZ Gazette in the calendar year 2015. Only nine firms were responsible for half of all liquidations and the top 44 firms take 86% of all liquidations. A total of 115 firms take appointments of ten files or less, most of these solvent liquidations.

The pool of active liquidators is very small and the commercial industry is self-regulating. Liquidators who obtain a poor reputation quickly fail to get repeat work and inexperienced insolvency practitioners never get appointed to large files.

In many ways, the most challenging element to being a successful insolvency practitioner is getting repeat business. Dishonest practitioners simply do not gain traction over the medium term.

This, of course, does not mean that a small minority of dishonest and inexperienced individuals are not attracted to the industry and can gain some work, but the Review of Corporate Insolvency Law was only able to identify a handful of cases all involving relatively small insolvencies.

The Debtor Friendly Liquidator

People respond to incentives. Most liquidators receives substantial referrals from accounting and legal professionals whose clients have got into trouble and the lawyer or accountant is looking for a 'friendly' liquidator who will not pursue their client too aggressively.

If the liquidator ignores the preferences of the referring professional and pursues the director aggressively, the referring professional will select a new liquidator for ongoing assignments.

Regulation will not resolve this issue. Nothing in the recommendations of this working group will do anything to alter this fundamental truth of the insolvency industry.

Liquidators are appointed in two ways; either by the courts or by the shareholders. The same firm of liquidators are likely to take a more aggressive approach to a court appointment, where they wish to impress the petitioning creditor, than to one where they were appointed by the shareholders.

It is not, therefore, accurate to claim that "…self-interested and debtor–friendly liquidator practitioners are largely unaccountable."[2] Liquidators are not debtor-friendly or creditor-friendly by

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[1] Review of Corporate Insolvency Law, July 2006. Page 3

[2] Review of Corporate Insolvency Law, July 2006. Page 3

inclination but in response to the incentives that they are exposed to, and nor are they unaccountable. There are accountable to the lawyer or chartered accountant who refers them the client.

There is no degree of regulation that will change this fundamental nature of the industry. Only a change in the underlying incentives that liquidators face will have the effect of getting liquidators to change their behaviour.

## The extent of the problem

The number of insolvencies in New Zealand is very small. A little over two thousand per annum against over half a million registered companies as per the Companies Office statistics. Almost all insolvencies of any size are taken by reputable insolvency firms with the requisite competence and experience.

The Review found a total of four liquidators who they felt should not be practicing, going back to 2009. Of these, only one is still taking appointments

## Regulation does not improve behaviour

It is assumed that once the industry becomes regulated that the behaviour will improve, but there is no actual evidence for this.

By contrast we need look no further than the heavily regulated Law Society. According to their 2016 report there are over twelve thousand lawyers. During the year there was a staggering 3,800 calls to the Complaints line and a total of 1,611 complaints laid.

At the time of writing, just over had of these complaints had been assessed with 145 complaints upheld. Seven hundred complaints are still be determined.

Over one percent of all lawyers had a complaint upheld, by their own society, in a single year with nearly half of the cases still unresolved.

There is no information as to the seriousness or otherwise of the upheld complaints but it highlights that regulation is not an inducement to good behaviour.

## Regulation; The Australian Experience

Insolvency practitioners have been regulated in Australia for several decades. However, in 2010 a senate inquiry revealed that, despite a strong regulatory regime, misconduct in the industry was rampant and even more draconian regulations and oversight by ASIC was put in place.

It isn't clear that this has improved behaviour. In a May 2013 report by the regulator, the Australian Securities and Investments Commission (ASIC) revealed that, despite there being only 525 licenced insolvency practitioners, 437 complaints were received and in 94 of these legitimate conduct concerns existed.[3] Thirteen liquidators had disciplinary or enforcement action taken against them and three were removed from the industry.

[3] ASIC Report 342 May 2013; Regulation of registered liquidators: January to December 2012

ASIC takes a very active role in monitoring insolvency in Australia but it isn't clear and there is no evidence that this activity enhances the returns to creditors in any meaningful way.

<u>The Costs of Regulation</u>

Regulation isn't free and the costs are more than just the additional costs imposed on the state by assuming a regulatory role.

First; there is the explicit costs of the additional tax-payer funded resources will be needed to undertake the oversight needed to provide an effective regulatory regime.

Second; there is the cost to the industry of compliance with the new regulations, costs that one way or another, directly or indirectly, will be passed onto creditors. This is especially the case if the regulation results in a reduction in the number of people practicing insolvency, leading to a reduced choice and the opportunity for licenced practitioners to change a premium.

Finally there is the cost of innovation and entrepreneurship that cannot survive in an overly regulatory environment.

Waterstone is a small innovative firm that has been active in the industry for a decade and would almost certainly not have come into being had we been faced with a significant regulatory oversight regime and we are not the only small innovative firm in the market who may not have come into being had the regulatory regime being proposed been in place when our respective businesses started.

<u>The choice of liquidator</u>

Much has been made in the Review of the importance of liquidators having experience and integrity. However, the fact is in almost all files nothing is ever done. The competence of the liquidator and their staff counts for nothing if the file isn't worked.

One of the main objections we hear from creditors is that the liquidators' inactivity and this can be best illustrated by the number of judgements obtained by the various liquidators.

In 2015 there were a total of thirteen judgements obtained by liquidators against directors for breaching their duties, and that was a bumper year. Normally the number is closer to four.

More importantly only two firms were involved. Three judgements were taken by Waterstone and the rest by Deloitte. No other firm took a single case to judgement and anecdotal evidence indicates that none of the other firms even filed any cases.

It is remarkable how many high profile and widely respected insolvency practitioners have no judgements to their name. Many have never sued a director for reckless trading, or indeed anybody for anything. This is incredible when you consider the inherent tension that should exist between a liquidator and the directors of the failed companies under their charge.

The emphasis on the integrity of the insolvency practitioner ignores the real problem, which is the inactivity of those currently taking appointments.

## Advantages of the proposed model

The proposed model as outlined in the draft legislation, which allows for the banning by the Ministry, of unsuitable insolvency practitioners and an improved registration regime is a sensible approach to what is a very minor problem.

Looking at the list of liquidators taking appointments there is perhaps only one gentleman who may be required to leave the industry under any of the proposed regulatory options. On that basis, the lightest hand seems the best one to use.

The relevant regulator could simply conduct a review and depending on the outcome of that review ban the individual subject to the review.

The Companies Office already undertakes this process with directors. Section 385 of the Companies Act 1993 gives the Register of Companies and the Financial Markets Authority the power to ban a person from acting as a director for five years.

Given the very small number of individuals being canvassed here, it is hard to see why this regime is not being advanced.

### The Flaws of Co-Regulation

The review committee, however, have proposed that we need a stronger form of regulation and have proposed co-regulation.

We strongly oppose this for a number of reasons.

Discipline

One of the key elements of any regulatory regime is the ability for people to take complaints against a member of the regulatory body. Given the tiny number of people involved the industry is too small for an effective co-regulatory discipline model to work.

If we contrast this with the Law Society or the Institute of Chartered Accountants, we can see large bodies with thousands of members. There is enough infrastructure within these bodies that independent and dis-interested individuals can be found to hear a complaint.

This isn't possible within the small confines of a relatively incestuous insolvency industry where everyone knows most of the other members of the profession, are often found at social events and where those who take the most appointments or their business partners, are going to be on the governing body.

The co-regulation model envisions, as it should, other professional bodies also moving into the co-regulation arena. This will continue to fracture the industry, making a robust complaint process increasingly difficult.

Based on this, it isn't feasible for a co-regulatory model to work in such a small environment as the insolvency arena. This is going to be especially true in the smaller provincial towns where there will only be one active insolvency practitioner.

Restrictive

If parliament allows the industry to regulate itself the most likely outcome is that very few new entrants will be allowed in.

Competition is detrimental to the earning potential of those who are already regulated and regardless of the best will in the world, the incentives to restrict membership to those already in the industry or to slowly move out of the industry those currently practicing, is going to exist.

This is going to reduce the options for shareholders and creditors, resulting in a less responsive and more expensive industry.

Governance

The members of the review have proposed RITANZ as the coregulatory agency. RITANZ has around three hundred members, many of whom appear to be employees of the larger law and accounting firms and this can be seen in those who are elected to its committee.

It is not a representative body. This isn't a criticism of RITANZ. It has done some good work and is a vital part of the wider insolvency industry; but its members and focus is clearly the larger insolvency firms, banks and law firms. It does not represent the wider body of insolvency practitioners who take as much as half of the appointments.

## State Regulation

If the intention is to regulate the industry it is our recommendation that this be handled by either the Financial Markets Authority or the Companies Office.

Regulation should consist of three elements.

Admission

Insolvency, for smaller files, isn't especially difficult. A competent liquidator needs to understand three pieces of Legislation;

- Parts 14, 15A and 16 of the Companies Act
- The Receivership Act (A mere 32 pages)
- The Personal Property Securities Act

For practical purposes, a chartered accountant, lawyer, or someone who has spent five years working in the insolvency industry, would be more than competent to tackle these issues. There should be an exception for the regulator to admit other candidates who can demonstrate suitable knowledge.

Larger files require more knowledge and an awareness of the wider commercial environment in order to maximise the return to creditors, but it is the nature of the insolvency industry that a person who has just become registered will not be given the chance to run a large file.

There should, of course, be a good character test. The insolvency industry, for reasons that are opaque, does have a number of active participants with criminal convictions for dishonesty. Usually (but not always) historical.

This category includes this author.

This should not be seen as a reflection of the type of people attracted to the industry, but a simply that people in professional services who have got into trouble have found a niche in insolvency. Discretion should exist for either the regulator or the High Court to review an applicant's past and recent behaviour to ascertain if they pass a good character test. A conviction should not be an automatic disqualification.

Review and Monitoring

Most professional bodies have a process for ensuring its members remain informed and periodically conduct practice reviews to ensure compliance with the relevant body's standards. It is feasible for the state to replicate this for the small number of insolvency practitioners but a process could be mandated that the insolvency practitioner and their firm must submit to an audit annually to ensure;

- Accurate time keeping records are being maintained
- Money is being held in an appropriate trust account
- That the liquidation reports accurately reflect the underlying transactions
- That the firm and practitioners are complying with all statutory obligations

It can be a requirement that the report from the auditor is sent to the regulatory authority annually. This has the effect of minimising the costs of monitoring whilst ensuring a robust process is being adhered to and that any irregularities are discovered and reported.

Discipline

This will be the most labour intensive element of the regulatory process. Based on similar reports the vast majority of complaints will be dismissed promptly. The regulator will need to dedicate resources to review and act on complaints.

Discipline is perhaps the most important of any regulatory regime. It is where those disgruntled with the process can seek redress and it is the importance and the real and perceived independence and it is the integrity of this process that invalidates any attempt by the existing industry players to self-regulate.

For a disciplinary process to be effective the regulator will need to establish a series of acceptable standards that regulated insolvency practitioners will need to adhere and outline the specific consequences for non-compliance.

Without going into the minutiae there should be three level of breaches;

- Trivial breaches for which a private warning is given
- Serious breaches for which a public warning is given
- Serious misconduct, which can include multiple serious breaches, for which registration is cancelled.

Overseas Recognition

From an industry perspective, state regulation is preferably as this is most likely to be accepted by ASIC and similar bodies that will allow NZ licensed practitioners to practice overseas.

The regulator will also need to assess overseas regulatory processes and decide which nations have a sufficiently robust process to allow overseas accredited practitioners to practice in Australia.

**Legislative Changes**

There are a number of legislative changes proposed.

S284 and s 286 of the Companies Act

There is an anomaly in the wording of these sections. It is unclear if the High Court can replace a liquidator and if and under what circumstances the Court can ban individuals from acting as liquidators. S 284 should give the Court unambiguous powers to replace a liquidator and s286 powers, on the court's discretion, to ban a liquidator for a period of time.

If this was corrected it is likely that much of the need for regulation, as outlined, would be negated.

S280(1)(cb) and the continuous business relationship; Secured Creditor

The review seeks to remove the restriction on liquidators who have a continuous working relationship with a bank holding a GSA from taking appointments. Under the current law, if the liquidator takes appointments from a secured lender, typically a bank, they cannot take on the liquidation.

This restriction makes sense. There is a very deep conflict between the GSA holder and the interests of the wider body of creditors. A GSA holder can appoint a receiver. The liquidator is there to represent the interests of the preferential and unsecured creditors. The independence of the liquidator is important, especially when there is often conflict between where the banks' security starts and ends.

A liquidator who has on ongoing stream of appointments from the GSA holder will not be seen to be independent from the bank when deciding what constitutes a secured asset and what an asset of the company is.

There is a restriction on a liquidator who has an ongoing business relationship with the shareholder and director because of this conflict. There is no reason to remove this restriction.

It may suit the members of the advisory panel (being large accounting firms and their lawyers) but the industry is large enough with sufficient depth accommodate this conflict.

S280(1)(ca) and the continuous business relationship; Company

The review panel seek to allow a firm that has been advising the shareholders and board of a struggling company to become their liquidators. This is not acceptable. The level of litigation against directors is already at a very low level and a common complaint from creditors is frustration as to what they perceive is the close relationship between various professionals.

From a practical perspective, it is often the banks who ask the accounting firm to go into the company to prepare an "Investigative Accounting" exercise on the business. This is usually done at the expense of the debtor. The Investigative Accountant then hopes to become appointed as receiver if this is appropriate.

It is better, from a public policy perspective, that this not happen. The Investigative Accountant, if precluded from taking an insolvency appointment, has no conflict and will focus on the main exercise; saving the business.

In any event, it is not appropriate for an accounting firm who has been getting paid from the shareholders and directors of an insolvent company to then become the liquidator. At a minimum there is the prospect of insolvent transaction against the accounting firm that cannot possibly be looked at objectively in such a situation.

There is also the prospect that the conduct of the advisors need to be examined more widely, especially if there has been an attempt to undertaken phoenix arrangement or the advisors have become de-facto directors.

The advisory group are probably thinking of themselves taking advisory work on the behalf of banks, getting paid by the debtor firms and then taking appointments. However, whilst I believe that this arrangement itself isn’t appropriate. I am more concerned with smaller insolvency firms taking engagements with insolvent firms, advising them over time on a restructure that has the effect of defeating creditors and then having themselves appointed as liquidator and ensuring that their own conduct will never be investigated.

**Measure 1; Remove the ability to appoint a liquidator after service of a liquidation application**

The law allows a company, on receipt of a liquidation application, to appoint their own liquidator or Voluntary Administrator for a period of ten working days after receipt of the court documents. This is commonly known as 'the ten day rule'. There is no need to remove this provision. In fact, the number of days should be extended to twenty.

This provision was included in legislation only in 2008, presumably in reaction to creditor, specifically the IRD's, frustration at shareholders appointing friendly liquidators in the final days before liquidation.

It is appropriate that a creditor not be put to the expense of incurring legal expenses only to have a shareholder liquidator appointed at the final moment. However, there is no reason to believe and no data provided to indicate that shareholders are appointing debtor friendly, dishonest or incompetent liquidators after getting a liquidation notice.

In fact, if the point of regulation is to remove so-called debtor-friendly dishonest and incompetent liquidator from the available pool of potential liquidators there isn't any need to retain the ten day rule.

However, there is still an advantage in a creditor having the right to request the High Court to appoint a liquidator of their choosing so imposing some restriction is suitable. However, ten days is very restrictive, giving the debtor company little time to get advice and consider their options.

It is important to understand that most debtor companies will be completely ignorant of the ten day rule and by the time they do seek legal advice the ten days are up. Extending this period to twenty days would grant the debtor companies more time to make a decision and, given the extended legal time frames, not have any negative impact on creditors petitioning to have a company liquidated.

The suggestion that the debtor should only be allowed to appointed a liquidator with the approval of the petitioning creditor, when in almost all cases the petitioning creditor will be the Inland Revenue works well for those insolvency practitioners who are the IRD's preferred liquidators. Who are also, as it happens, those who authored the recommendation.

Before such a change was implemented, it would be preferable if those more likely to be affected were canvassed.

A better change would be to make it mandatory to point out to debtor companies the existence of the ten day rule to debtor companies who are in receipt of a liquidation application.

**Measure 2; Avoid transfers of assets after service of a liquidation application**

In principle this change has merit. It isn't apparent how often such transfers actually occur. In our experience we rarely if ever see such a transfer but perhaps that is a reflection of the nature of our appointments.

The problem is going to be defining what an asset is. Cash, accounts receivable and inventory are all assets and in most smaller firms the only actual assets of value.

**Measure 3; A Director Identification Number**

There isn't any doubt that, from an insolvency perspective such a measure would be helpful. However, there are wider social implications around privacy and liberty that may raise concerns.

It is important to appreciate that the number of directors likely to be caught by this provision will be very small. Probably less than ten. However, there are 550,000 registered companies with possibly as many directors. The administrative processes and costs to the vast majority of honest directors and the tax payers to resolve what is a tiny problem is disproportionate.

**Additional Measures**

If the objective is to improve the behaviour of active insolvency practitioners there isn't any reason to think that regulation will have anything other than a marginal effect.

What will have a positive effect will be to align the incentives of liquidators and those who we serve; the creditors.

Ease of replacing liquidators

Replacing a liquidator is very difficult. At a creditors a resolution to replace a liquidator must obtain;

50% + 1 by number of all creditors voting

And

50% +1 by dollar value of all creditors voting

There is no restriction on related party voting. In the event that the liquidator was appointed by the High Court, the liquidator must then go back to court and the court will then decide if they will replace the liquidator.

In practical terms this means that a liquidator appointed by the shareholders can survive a challenge by angry creditors seeking a more aggressive liquidator by having all of their former staff voting. A typical example may be ten staff, with collective debts of a few thousand dollars and eight trade creditors with a million dollars in unpaid bills.

The vote to replace the liquidator will fail even through the vast majority of creditors by dollar value want a new liquidator because a small number of creditors friendly to the director want to retain the status quo.

A vote to replace a liquidator should pass if it has;

A simple majority by dollar value of third party creditors

A minimum of 25% of creditors by number

Related party creditors should be excluded from voting

This means that 75% of creditors by number oppose the replacement liquidator then the incumbent can remain in office, but otherwise those creditors most effected, being those with the greatest debt, can determine who the liquidator is.

Related party creditors should be excluded from the voting at a creditor's meeting. This does not mean that they are to be excluded from any distribution, but it isn't appropriate for interests associated with the directors and shareholders to have a say in the appointment of a liquidator.

Finally, the distinction of court appointed and shareholder appointed liquidators at a creditor meeting should be abolished. If a court appointed liquidator is replaced at a creditor's meeting then the need to go back to court to validate the creditor's decision should be scrapped.

Voting at Voluntary Administrations Watershed meetings

In Australia the voting at a Watershed meeting of creditors in a Voluntary Administration (VA) is clearly laid out in very specific terms.

In order to pass a Deed of Company Arrangement (DOCA) the creditors must approve the DOCA by a vote representing;

> More than 75% by Creditors by dollar value
>
> And
>
> 50% + 1 by value.

In the event that the DOCA vote gets one of these two but fails on the other, the Voluntary Administrator can exercise a 'casting vote' to push the DOCA over the line.

There is a body of case law on the appropriateness of exercising this casting vote and it isn't to be used lightly.

Upon the passing of the New Zealand VA legislation in 2008, (part 15A of the Companies Act) the assumption was that the casting vote in the NZ legislation had the same meaning as in the Australian case.

However, in one test case in which the author was involved[4] the Court of Appeal upheld a High Court decision that the wording of the NZ legislation was narrow and that a casting vote could only apply in the event that the number of creditors were tied.

As a consequence the VA regime withered. Almost no insolvency practitioner will undertake a Voluntary Administration. Our VA regime diverges now from the Australian model in a significant manner. At the time the intention was to have the two systems to be as similar as practicable.

It is worth giving consideration to parliament altering the legislation on this point to allow Voluntary Administers the ability to use their casting vote in the same manner as an Australian Voluntary Administrator.

Preferential Creditors in a Voluntary Administrations

In the same litigation, the issue of the IRD's preference in a VA was raised. The DOCA as proposed treated the IRD's preferential debt as being equivalent to that of an unsecured creditors. This was, less surprisingly, rejected by both the High Court and the Court of Appeal.

The IRD's preference is a controversial topic and it is disappointing it has been excluded from this review but in the narrow confines of the Voluntary Administration regime a DOCA should have the power to compromise the IRD's preferential debt.

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[4] Grant and Khov v the Commissioner of Inland Revenue CA357/2010 [2011] NZCA 390

**Two Case Studies**

It might be helpful to showcase two case studies where Waterstone, by taking a non-traditional approach to insolvency, achieved remarkable results for creditors. These are two cases selected merely to highlight the value of innovation in the insolvency industry, innovation that is likely to be thwarted by a heavy handed regulatory regime.

NZ Properties Holdings Limited

This company owned a hotel in Rotorua and became involved in a dispute with their tenants in 2008. They were placed into liquidation by the High Court in 2012 with Waterstone appointed.

It became apparent very quickly that the directors and shareholders had considerable exposure for the way they had traded their business and that there was economic merit in pursuing litigation.

However, the shareholders had considerable economic resources. Attempts to obtain litigation funding were unsuccessful and in a creditors' meeting called by related party creditors Waterstone was replaced by a firm of Chartered Accountants.

The High Court agreed with the shareholder's submissions that Waterstone had been 'unnecessarily aggressive' and Waterstone was replaced. [5]

The Court of Appeal reinstated Waterstone[6] and we later settled with the shareholders for two million dollars. In an agreement with the creditors early on in the process, it was agreed that Waterstone could take half of this amount in fees and the other half went to the creditors.

There were fourteen High Court judgements involved in this matter as the shareholders resisted every attempt by the liquidators to obtain the books and records. Hundreds of hours of legal and administrative time was invested by Waterstone in this litigation.

None of this was paid until settlement was reached, which took over three years.

The debt owing to the creditors was 1.3m. This was an excellent result for the creditors, a retired and impoverished couple who had lost everything in this dispute.

Two points are relevant here. Waterstone employs our own team on in-house lawyers and we were willing to fund this ourselves.

PHVS Project Limited

This was a development company that was placed into liquidation by the shareholder. The liquidator wrote their final report and moved to strike the company off after several months.

One of the creditors objected and Waterstone was appointed by the Courts as a replacement liquidator.

After a protracted investigation the shareholders settled, paying $100,000 of which $75,000 went to the creditors.

[5] Grant and Khov v CP Asset Management and Others CIV-2012-404-005014 [2012] NZHC 3488
[6] Grant and Khov v CP Asset Management and Others CA67/2013 [2013] NZCA 452

A Different Model

In both cases the other firm of liquidators were Chartered Accountants. It is important to stress that in neither case did they do anything wrong. No one can be forced to work without being paid and no criticism can ever be laid at anyone's door for not willing to take on contingency work.

However, the existence of a firm like Waterstone and similar firms like ours, notably Robert B Walker in Wellington, gives creditors a choice. Regulation should not be so heavy handed as to stifle innovative firms who provide alternatives.

**Judicial Comment**

It is easy for a firm to claim that they are respected. Such recommendation has no value of course. We attach, for completeness, some judicial comment

**NG v Harkness Law Limited**
CIV-2013-485-1389 [2014] NZHC 1667

[16] There are the liquidators. They are now Mr Grant and Mr Gilbert. They are known to be liquidators who will pursue the interests of creditors in cases of insolvent liquidations. There is no suggestion that they would not be competent or willing to enforce claims against the directors or against those who had dishonestly assisted directors.

**Grant v Lotus Gardens**
CIV-2013-488-5 [2015] NZHC 2345

[14] The proposed replacement liquidators in this case have the experience and the resources to carry out an investigation. They are known to the Courts from their involvement in numerous liquidations. Any questions that arise as to whether they should be appointed are not connected with the competence of the liquidators but whether the course of action which they propose is to the advantage of the company.

**NZNET Internet Services Limited (in liq) v Engini Ltd**
CIV-2015-404-002544 [2015] NZHC 2713

[21] Subject to that consideration I accept that it is appropriate to appoint Messrs Grant and Khov as interim liquidators. I say that because they have obviously built up significant background knowledge and information as to various companies with which Mr Andrews was involved….

[22] I am reinforced in my confidence. Messrs Grant and Khov were appointed by shareholder's resolution. Unlike some vanilla liquidations, they have pursued the interests of creditors of NZNet Internet Services vigorously. I appoint them as interim liquidators.

**Grant v CP Asset Management Ltd;**
CA67/2013 [2013] NZCA 452
[58] As the Judge recognised, recovery for the creditors also required during for any recovery actions that the investigation may disclose. That is so because the company is asset less. There is a significant difference, as we see it, between Mr Grant's offer to fund such actions and the possibility that an external funder will agree to do so.

**Appendix One**

| Firm | Liquidations | Cumulative % |
|---|---|---|
| PwC | 260 | 12% |
| Official Assignee | 144 | 19% |
| KPMG | 133 | 25% |
| Shephard Dunphy | 110 | 30% |
| Deloite | 105 | 35% |
| Reynolds, Grant | 90 | 39% |
| McDonald Vague | 82 | 43% |
| Rogers Reidy | 73 | 47% |
| Insolvency Management Ltd | 70 | 50% |
| Meltzer Mason | 52 | 52% |
| Waterstone | 52 | 55% |
| C&C (John Gilbert) | 50 | 57% |
| Victoria Toon | 47 | 59% |
| BDO | 43 | 61% |
| Thompson, Kim | 36 | 63% |
| Gerry Rea | 31 | 64% |
| Alliott, Murray | 31 | 66% |
| EY | 30 | 67% |
| Fisher White | 30 | 69% |
| Smith, Bryce | 30 | 70% |
| Horton, Chris | 26 | 71% |
| Ecokis KGA | 20 | 72% |
| Kamal, Imran | 17 | 73% |
| PKF Auckland | 17 | 74% |
| pkf CHCH | 16 | 74% |
| Thomas, David | 16 | 75% |
| Nexia | 15 | 76% |
| Laing, Trevor | 15 | 77% |
| Young, Craig | 15 | 77% |
| Grant Thornton | 14 | 78% |
| CS Insolvency | 14 | 79% |
| Faloon (Biz Rescue) | 14 | 79% |
| Patel, Pritesh | 14 | 80% |
| Whittfield | 14 | 81% |
| RES, Digby | 13 | 81% |
| Surendran, Biju | 13 | 82% |
| Pattison, Tony | 12 | 82% |
| John Scutter | 12 | 83% |
| Taurus | 12 | 83% |
| Bennett & Associates | 11 | 84% |
| Managh, John | 11 | 84% |
| Norrie & Daughters | 10 | 85% |
| Nair, Daran | 10 | 85% |
| Staples Rodway | 10 | 86% |
| Others < 10 | 304 | 100% |
| Total | 2144 | |