J. A. Russell Ltd
ELECTRICAL & DATA SUPPLIERS

30 June 2017

The Ministry of Business, Innovation and Employment

By email: corporate.law@mbie.govt.nz

SUBMISSIONS ON THE REVIEW OF CORPORATE INSOLVENCY LAW – REPORT NO.2

1 I write to you on behalf of J. A. Russell Limited.

2 J. A. Russell Limited is an electrical wholesaler. Our core business is the supply of electrical and data goods to electrical contractors on credit. Unfortunately in the course of our business, from time to time, a customer will go into liquidation, and we have faced a number of voidable transaction claims.

3 We wish to make a brief submission on some of the proposals concerning voidable transactions set out in Report No.2 of the Insolvency Working Group.

4 In summary, our main comments are:

Regime Balance

4.1 We think that any changes to the voidable transaction regime need to err on the side of protecting good faith individual creditors. While the concept of protecting creditors' collective interests looks good on paper, in our limited experience of the current regime, we have only ever seen voidable transaction claw backs cause significant harm to good faith individual creditors with the recovered money going only to the IRD and/or liquidator fees (and not creating any benefit for the large group of ordinary unsecured creditors).

Recommendations 1 and 2

4.2 In our view, the 'package' proposal of repealing the 'gave value' test within section 296(3)(c) and reducing the vulnerability period for clawback to six months does not strike an appropriate balance between an individual creditor's interests and creditors' collective interests. We think that balance would be better struck by:

(a) removing the IRD's status as a preferential creditor (in line with Australia); and

(b) retaining the 'gave value' test as part of the s 296(3) defence while reducing the vulnerability period for clawback to six months (again, as we understand things, in line with Australia).

Recommendation 26

4.3 Limiting the IRD's preferential claims to six months from the date the debt falls due is a step in the right direction. However, as mentioned above, our view is that the IRD preference should be removed entirely, leaving the IRD ranking alongside other unsecured creditors.

5 We do not comment on Recommendations 3 – 5 because we have no experience with these issues. But, as a point of general principle, we agree that a liquidator should have a greater ability to claw back undervalue transactions and transactions with related parties.

6 We agree with Recommendations 6 - 13 and see these as balanced improvements to the voidable transaction regime.

7 In relation to Recommendation 20, we can see the benefits of permitting liquidators to obtain third party records without applying to the Courts. Our only comment is that that liquidators' power should be limited to requesting documents which are necessary, and that the third party should be entitled to recover reasonable expenses of complying with such a request.

Typical scenario in which we experience voidable transaction claims

8 Before we expand on our main comments, it may be helpful if we explain a common scenario in which we have encountered voidable transactions. That scenario is:

8.1 we trade and extend credit to a business (often for a number of years) and then that business suddenly goes into liquidation, when we are not aware of any significant financial difficulties;

8.2 the debt we are owed for goods supplied is unrecoverable;

8.3 we are served with a voidable transaction claim by the liquidator;

8.4 at that point, we find out for the first time that the business in liquidation owes significant tax debts and, in many cases, these debts are a number of years overdue.

Expanded comments regarding Recommendations 1 and 2 – repealing 'gave value' and reducing the vulnerability period for clawback

9 The Supreme Court's decision in *Allied Concrete* was a welcome development in our view. The decision provided our business and our customers with increased certainty after a period of years during which we (and our customers) received an increasing number of voidable transaction claims. We are pleased to see that the report acknowledges that the law as understood before the Supreme Court's decision gave too much weight to the collective interests of creditors.

10 In our view, the 'package' proposal of repealing the 'gave value' limb of the s296(3) defence and reducing the clawback vulnerability period does not strike an appropriate balance between an individual creditor's interests and creditors' collective interests.

11 First, we consider that the protection of creditors' collective interests objective (also referred to as the principle of equal sharing among creditors of the same class) would have much more credence (and be much more widely accepted by the individual creditors who currently feel hard done by voidable transactions) if the IRD's status as a preferential creditor was removed as part of any reform package – putting the IRD on the same footing as the generally large pool of ordinary unsecured creditors. As Report No.2 notes, the IRD is usually better placed than other creditors to assess whether a company is insolvent. If a company has significant tax debt and the IRD takes no action, businesses like ours may continue

to extend credit well after a company has become insolvent, without any knowledge of it. That can lead to what we view as a particularly unfair scenario, in that:

11.1 while we continue supplying the company, the IRD debt continues to grow;

11.2 after the company goes into liquidation, the IRD as a preferential creditor will be paid some of its debt, while the other unsecured creditors (such as our business) will be left wholly out of pocket;

11.3 if we do manage to get paid in the period prior to liquidation, those amounts are clawed back from us and, in our experience, are only ever redistributed to the IRD as a preferential creditor or used to pay liquidators fees; and

11.4 more generally, in liquidations in which we have lodged a claim as an unsecured creditor we have never received any distribution from recoveries of a voidable transaction claim.

12 The collective interests of creditors would be best served by putting the IRD on a level playing field with all other unsecured creditors. Not least of all, it would prompt the IRD to take action about outstanding tax debt at an earlier stage and help companies like ours avoid extending credit to insolvent companies. On that latter point, we welcome the recent change allowing the IRD to inform a credit reporting agency if a company owes over $150,000 in tax.

13 Second, under the proposed package, it will still be possible that a small business (like an electrical contractor) will do a job for a customer in good faith (without any reason to suspect the customer is in financial difficulty), get paid, use that money to pay its own bills and, if the customer then goes broke in the next 6 months, have a liquidator come along and claw the payment back. We feel this is extremely hard on the small business "good faith individual creditor". The proposed package means that no business that supplies goods or services on credit can have certainly that they can keep any payment received until 6 months have passed. We know of no business that can afford to hold payments received in reserve for 6 months - awaiting this certainty. The Supreme Court's decision in *Allied Concrete* protects small businesses from this scenario where they have acted in good faith and there were no reasonable grounds to believe the customer was insolvent. We think this protection should remain. While reducing the potential claw back period from 2 years to 6 months (as currently proposed as part of the package) will reduce the risk of such claw backs, we do not think this is a sufficient reason to depart from the Supreme Court approach.

14 We understand that in Australia the claw back period is 6 months, the IRD is not a preferred creditor and the good faith/no solvency suspicion/gave value defence operates in a manner consistent with the *Allied Concrete* Supreme Court decision. We think New Zealand should adopt the same position.

15 For completeness, we note that our comments to restricting voidable transaction claims do not relate to transactions at undervalue or transactions between related parties.

General comment

16 More generally, our view is that any regime should err to the side of protecting individual creditors. In our industry, it is common for customers to have difficult patches. In our experience, businesses are often able to trade out of such situations

when they are extended support in the form of more time to pay and further credit. When a fundamentally good business is able to trade through a difficult patch and continue on, we think this is really beneficial for the whole market. But it is much more difficult for our business (or any other business that has long term customers that purchase goods or services on credit) to take the risk of supporting a customer through a difficult patch when you feel you are risking both the amount of additional credit given and (because of the voidable transaction regime) any payments received. The very act of allowing invoices to be paid outside of the stated terms may create a situation where the business is not paying its debts as they fall due and leave us exposed to the risk of a later voidable transaction claim.

Recommendation 26: limiting the IRD's preferential claims

17 Further to our comments in respect of Recommendations 1 and 2, limiting the IRD's preferential claims to six months from the date the debt falls due is a step in the right direction. However, in many cases we expect that will still result in no recoveries for unsecured creditors.

18 Accordingly, our view remains that the law be changed so that all tax debts rank equally alongside other unsecured claims, in line with the position in Australia and the UK.

Yours faithfully

Legal Counsel - J. A. Russell Limited