Submissions on the Review of Corporate Insolvency Law

Report No. 2 of the Insolvency Working Group, on Voidable Transactions, Ponzi Schemes and other Corporate Insolvency Matters

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 formal 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 more than 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 IWG's Second Report (the 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. As such, PWC are well placed to provide submissions on the IWG's Report.

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

Recommendation 1:
Repeal the 'gave value' part of the test in section 296(3)(c) of the creditor's defence, restoring the defence to one that operates only where a creditor, in good faith and without suspicion of insolvency, relies on the payment itself.

AGREE

We agree for the reasons stated in the report; - namely that this amendment will restore the balance somewhat more in favour of the collective interests of creditors and reduce administration and compliance costs.

Voidable transactions are a contentious area of insolvency law as creditors typically (and understandably) feel aggrieved when having to repay money that it is owed to them in the first place. However, transactions that are identified as being voidable represent only a small part of the large number of commercial transactions that occur every day between businesses in New Zealand. As a result, it is important in an insolvency context that due weight is given to the collective interests of creditors so that all creditors (within the same class) have the opportunity to share equally.

Recommendation 2:
Reduce the period of vulnerability for insolvent transactions (section 292) from two years to six months where the debtor company and the preferred creditor are unrelated parties.

DISAGREE; - SUGGEST THAT THE PERIOD BE REDUCED FROM TWO YEARS TO ONE YEAR

We consider that the policy objective of providing a greater level of commercial certainty to individual creditors can be adequately achieved by shortening the claw back period to one year in place of the current two year period.

We consider that whilst a six month claw back period may provide greater commercial certainty to individual creditors, this short time frame would unduly harm the interests of all unsecured creditors by unduly limiting the pool of recoveries that would otherwise be available to liquidators.

We have reviewed a sample of 28 voidable transaction recoveries made over the two years from 1 July 2015 to 1 June 2017. The payments recovered totalled $522,990. Had the liquidators been restricted to recovering those transactions made within the proposed six month claw back period, the recovery would only have been $108,627; or 20% of what was actually recovered.

We do accept that repealing the 'gave value' part of the s 296 defence could result in an increased recovery rate in respect of voidable transactions. However, in our experience voidable transactions account for a significant proportion of our recoveries able to be achieved for the benefit of creditors and we are concerned that the effect of the proposed six month claw back period, if adopted, will substantially diminish potential recoveries.

In any case, we believe based on experience that a large proportion of liquidations are in respect of companies that have already ceased trading, many of which ceased trading more than six months prior

to the application for liquidation being filed. In our opinion a six month claw back period is simply too short.

If it is not accepted that the claw back period should be reduced to one year, then our position is that there be no change from the current regime.

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

Recommendation 3:
Retain the two year period of vulnerability for clawbacks for unrelated party transactions at undervalue.

AGREE

In our view the level of mischief and potential harm caused to the general body of creditors warns against any reduction in the clawback period.

Recommendation 4:
Standardise the period of vulnerability for all clawbacks under sections 292, 293, 297 and 298 at four years where the debtor company and the preferred creditor are related parties.

AGREE

We agree with the change as otherwise there is significant risk of directors 'engineering' a situation where, by the time a company is placed into liquidation, related party transactions fall outside the clawback period.

We have witnessed a number of examples over the years where transactions that fall outside the two year clawback period would otherwise be voidable. For instance, a scenario where a tax audit is undertaken of a debtor company, tax is assessed for prior periods and in those prior periods the directors or the shareholders repay loans to themselves. The debtor company then defends the tax assessment and after a period of time the debtor company is eventually placed into liquidation but over two years has lapsed, so there is presently no ability to clawback the repayment of shareholder loans.

Recommendation 5:
Use the definitions of 'related creditor' and 'related entity' that appear in section 245A (and section 239AM) of the Companies Act for determining whether a party is a related party in relation to all recoverable transactions, charges and securities.

AGREE

We agree that it is desirable that the related party definitions are defined more expansively and with greater clarity and that the recommended sections are appropriate.

Recommendation 6:
Retain the presumption of insolvency in relation to transactions and charges in the six months prior to the commencement of a liquidation.

AGREE

The large majority of the insolvent liquidations that we undertake are in respect of companies that were insolvent for at least six months. Therefore, in our experience it is rare for a creditor to prove solvency of the debtor company, albeit they will sometimes attempt to do so.

Recommendation 7:
Reduce the deadline for liquidators to file in the High Court claims under sections 292 to 299 from six to three years.

AGREE

We agree that it is in the interests of achieving greater commercial certainty that the deadline be reduced to three years.

Recommendation 8:
Provide the High Court with the discretion to extend the filing period under sections 292 to 299 if it would be just and equitable to do so.

AGREE

We think there needs to be an ability to deal with unusual situations; such as where liquidators have been obstructed from carrying out their duties by directors or shareholders by failing to provide records. Liquidators having the opportunity to apply to increase the time limit provides a balance to a limitation period of only three years.

Recommendation 9:
Add a defence for a creditor with a valid security interest who can demonstrate that there was no preference at the time they received payment.

DISAGREE

We believe that the voidable provisions need to be consistent. The current test as to whether a creditor has received a preference is to assess the payment against what amount the creditor would have received in the actual liquidation. Providing exceptions to the test as is being proposed under this recommendation further complicates an already contentious area of insolvency law.

Recommendation 10:
Simplify the continuing business relationship rule in section 292(4B) of the Companies Act by removing the subjective element relating to the parties' intentions.

DISAGREE

We do not consider the requirements imposed by the section to be particularly onerous on liquidators in terms of administration costs such that any departure from the existing process is warranted.

The proposed simplifying of the process of netting off supplies and payments between the debtor company and the creditor has a theoretical attraction. However, this fails to recognise practical issues such as where there might have been a cessation of supply (and therefore an end to the continuing business relationship) which ought to be taken into account. Under the proposed change, any such cessations would be ignored.

This means that even where it can be shown that the creditor knew, or ought to have known, of a company's insolvent position by virtue of having cut off supply, the payments received in the intervening period will not be able to be voided. Such an outcome is inconsistent with the policy objectives and we do not consider that any compelling reason/s exist to warrant a departure from the existing regime.

Recommendation 10:
Clarify that the starting point for a continuing business relationship is the start of the specified period or the point of the debtor's insolvency, whichever is later.

AGREE

We agree that this is desirable in order to provide clarity and this approach is consistent with case law.

Chapter 3 – Procedural issues relating to voidable transactions

Recommendation 12:
Amend section 294, relating to the content and form of a liquidator's notice for setting aside transactions, by replacing the current list within section 294 itself, with a power to prescribe the content and form by Order in Council.

AGREE; - BUT MAKE CHANGES TO THE NOTICE OF OBJECTION TOO

We support the proposed change on the basis that one of the underlying concerns to be addressed is the '*large differences in the quality of information liquidators provide to creditors*'.

Equally we believe there needs to be greater clarity in relation to the documents that the recipient party is meant to describe in their notice of objection under section 294 (4) of the Companies Act 1993 (the Act). In our experience there is much inconsistency in the details and the identifying of documents that the recipient party relies on in the objection. We suggest that recipient parties should be required to list the documents they rely on and provide these documents at the same time as the objection.

Recommendation 13:
Prescribe the following content under the Order in Council:

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

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

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

AGREE - WITH SOME RESERVATIONS

We generally agree with the recommendation on the basis that providing creditors with as much basic information as possible will assist them to prepare an informed response. In particular, we support the inclusion of obtaining legal advice.

Our reservation is that including a great deal of additional information under the proposed order "c" above could make the liquidators' notice too long and prescriptive. This could be counterproductive in that recipients may be less inclined to read the notice in full.

We therefore propose simple wording to the effect that "the creditor is advised to seek urgent legal advice in relation to this notice and whether the transactions are in fact voidable under the provisions of section 292 of the Act or whether the statutory defences under section 294 (3) of the Act apply".

Recommendation 14:
Provide that the clawback period commences from the date of appointment of the voluntary administrator if the creditors decide to appoint a liquidator at the watershed meeting.

AGREE

We agree for the reasons stated in the report. We have seen examples of where this discrepancy has occurred and it needs to be rectified.

We also believe that where a Deed of Company Arrangement fails, and the company is put into liquidation, consideration should be given to the claw back period beginning at the date of voluntary administration under this scenario.

Recommendation 15:
Clarify that the recoveries under sections 292, 293 and 297 to 299 should be paid out in the order specified under Schedule 7 of the Companies Act.

AGREE

We do not believe that such recovery claims from liquidator actions are payable to creditors with security interests in any case. However, we agree that it is desirable to expressly clarify this matter in order to provide certainty.

Comment on a possible materiality threshold and ring fencing of proceeds

We agree that the administration costs incurred by a liquidator represent a pragmatic restraint to pursuing low value and low probability claims and so there is no need to set a materiality threshold.

We also strongly agree that proceeds from voidable transactions should not be ring fenced. Proceeds from a voidable transaction recovery should be able to be applied to liquidators' general costs as it can often provide the financial means that enable the liquidators to then pursue larger and more complex actions that may result in a greater recovery for the general pool of creditors.

Chapter 4 – Ponzi schemes

Recommendation 16:
After the Supreme Court releases its decision in McIntosh v Fisk, the Government should assess whether there is any need to make the following changes:

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

AGREE

As PwC Partners are the Receivers and Liquidators of Ross Asset Management Limited (RAM) and related entities PwC is well placed to understand the issues surrounding the winding up of a Ponzi scheme. It is important to understand that the creditor profile will be different than the usual corporate insolvency event. Often the creditor pool will comprise many smaller investors, being individuals and family trusts, many of which may have limited investing experience and will be looking to maximise their retirement, often without a diversified portfolio of investments on which to rely should one fail. A Ponzi scheme, promising high consistent returns, will often be attractive particularly to those less sophisticated investors who may find retirement without the anticipated savings they need to sustain themselves.

We agree that it would be useful to have a Ponzi presumption in the Property Law Act 2007 (the Property Law Act). In our opinion, concerns about the degree to which a company will be operating a Ponzi scheme are more theoretical than practical. Provided the criteria for identifying a Ponzi scheme are fairly clear. We would recommend criteria along the following lines:

1. Deposits are taken by some form of investment manager. The nature of the investment is probably irrelevant if the other criteria are met;
2. Investors are advised that their deposit is used in a certain way and what return is being generated on the funds;
3. The deposits are not used in the manner advised either in part or in full. A key component of the misapplication of the funds will be that it is instead used to pay out reported returns to other investors. Without the payment to other investors it will simply be a case of fraud against the investors, not a Ponzi scheme, so the presumption will not apply; and
4. Even if the above criteria do not apply to all transactions it should still be deemed a Ponzi scheme as inevitably some deposits will have been used to pay out other investors' returns. In the event that an investor's deposit has not been used to sustain the Ponzi scheme there will likely be a valid proprietary claim to the reported assets, or a claim against the Company for breach of trust.

The US Securities and Exchange Commission has clear guidelines around what constitutes a Ponzi Scheme and Red Flags that investors should be aware of. This would appear to be a helpful guide to defining what will constitute a Ponzi Scheme. https://www.sec.gov/fast-answers/answersponzihtm.html

One of the questions we have been frequently asked in relation to RAM is "When did the Ponzi start?" Due to the extended period of time over which deposits were taken full records were not available so this was not a question which could be definitively answered. A Ponzi presumption would help

mitigate some of the costs associated with attempting to determine this question. Those investors whose deposits were not intermingled with other investor funds may still have valid proprietary claims. This may result in a different outcome than the Priest v RAM decision where an investor's proprietary claim was upheld notwithstanding the fact that their assets were intermingled with other investor assets due to the nature of the relationship the investor had with RAM, rather than how the assets were strictly dealt with.

Under the proposed change to remove the value defence from the voidable transactions sections of the Companies Act a markedly different outcome than was decided in the Supreme Court would have resulted in McIntosh v Fisk. In that case Mr McIntosh was successful in arguing that he had provided value insofar as he had a claim against RAM for the value of his initial contribution and accordingly was only required to repay the "fictitious profits" he had been paid. The revised outcome would lead to a claim under the Companies Act being applicable to all payments made to the investor, whereas a claim under the Property Law Act may only be successful in relation to the fictitious profits element.

There is some logic in holding that investors in a Ponzi scheme should not be subject to the same strict obligations as a commercial creditor in relation to a voidable transaction claim. Often these investors will have been under the mistaken presumption that they still hold investments even when the Ponzi scheme is uncovered.

The Property Law Act will have a Ponzi presumption but also a value defence meaning only "fictitious profits" need to be repaid, as in *McIntosh*. This helps reinforce that the Property Law Act is probably a better fit for dealing with a Ponzi scheme, which is ultimately a type of fraud. The Companies Act is intended to deal with commercial business transactions, where in general concepts such as fictitious profits do not arise.

b) The establishment of a compensation scheme.

DISAGREE

In terms of establishing a fund to assist victims of Ponzi schemes we agree with the IWG that such a fund would likely be untenable in the small New Zealand market. In any event it would be difficult to argue why such a fund should be limited to the victims of Ponzi schemes when investors are also at risk from other types of fraud, such as the investment manager simply taking the investor's deposit and spending it solely on themselves.

CHAPTER 5: Other corporate insolvency law issues

Recommendations – Companies Act

Recommendation 17:
Amend, for the purposes of Part 16 (Liquidation), the definition of 'secured creditor' to include all creditors holding a security interest as defined in the Personal Property Securities Act 1999.

AGREE

We agree with the recommendation to make the definition of secured creditor consistent with the Personal Property Securities Act for the purpose of Part 16 of the Act.

Recommendation 18:
Provide that recoveries from reckless trading claims are not available to secured creditors but instead are distributed only to unsecured creditors (including preferential creditors).

AGREE; - BUT WITH AN AMENDMENT

On the face of it this recommendation makes sense on the basis that the misfeasance of the directors has resulted in a loss to unsecured creditors in a liquidation and therefore any recovery should be returned to those same creditors.

However, the concern around the recommendation limiting recoveries for misfeasance claims to the unsecured creditors is that there may well be circumstances where the misfeasance has in fact resulted in loss being suffered by the secured creditors. The collapse of the various finance companies provides examples where, in a number of instances, Receivers have taken proceedings against the directors for misfeasance as a result of the losses suffered by secured debenture holders and the resulting settlements have been returned to those secured debenture holders.

A more appropriate amendment would be to provide that reckless trading claims are only available to third party secured creditors. This avoids the situation where a director is required to satisfy a security against the company to a third party financer under a personal guarantee and then the director subrogates into that same security. Liquidators are unlikely to proceed with the reckless trading claim if the proceeds are going to go back to the director. If in this situation a director was not able to obtain the benefit of his or her security then liquidators would still be able to bring a claim on behalf of the unsecured creditors who have also lost money as a result of the director's actions.

It should also be noted that a secured creditor can value its security and surrender the balance, thereby making them unsecured and entitled to share in the misfeasance recoveries.

Recommendation 19:
Require all administrators' reports to be filed with the Registrar of Companies.

AGREE

We agree that the Voluntary Administrators' Report should be filed with the Registrar. The compliance cost of doing so is low and it would be beneficial for future trade creditors in the event that the rehabilitation is successful.

Recommendation 20:
Provide powers to liquidators to obtain certain information from third parties without needing to apply to the courts.

AGREE

We agree that greater clarity around this section permitting liquidators to obtain documents from third parties would be beneficial, especially suppliers. However, there should be limits to the amount of information provided to avoid substantial costs being incurred. Suppliers should be able to provide such information as invoices, account statements and correspondence out of their own systems at a relatively low cost.

Recommendation 21:
Align the meaning of 'telecommunications services' in the Companies Act and the Receiverships Act 1993 with the meaning of 'telecommunications service' in the Telecommunications Act 2001.

AGREE

Recommendation 22:
Provide that fines and penalties are admissible claims in liquidation, but are subordinate to claims by unsecured creditors.

AGREE

We agree with this proposed change. The current inconsistent treatment can be problematic such as in a circumstance where there are fines over a vehicle which a liquidator needs to dispose of and the existence of those fines does not come to light until later. The ability to enforce those fines also needs to be restricted in the same way as other creditors cannot enforce their rights upon the appointment of liquidators.

Recommendation 23:
Allow communication by electronic means between the liquidator and creditors.

AGREE

We agree with the proposal. However, we believe that creditors need to be given a choice as to how they receive their communication. In some instances creditors may prefer paper reports and should be able to opt out of electronic communication. When they complete their proof of debt form. Otherwise liquidators should be able to send an electronic copy of communications if an email address has been supplied by the creditor.

A practical approach could be that the first report must still be sent to all creditors in hard copy but can include a statement advising that future communications will be electronic but creditors can elect to receive hard copy reports when they complete their proof of debt form. This is similar to the process the Official Assignee uses in its reporting.

Recommendation 24:
Clarify whether long service leave forms part of the preferential claim for employees.

AGREE

We agree that clarity around leave entitlements is required. The purpose of making employee entitlements preferential is because they are in a vulnerable position and that needs to be protected. Our opinion is that these entitlements should be preferential but still subject to the employee preference cap.

Recommendation 25:
Establish a new preferential claim for gift cards and vouchers, with the same ranking as layby purchases.

AGREE; - BUT WITH RESERVATIONS

We agree that these payment methods should be given preferential status. It would simply be updating the law to reflect modern retail practices, recognising the vulnerable position consumers are in in relation to retail operations.

However, our concern is with other similar payment methods, including loyalty programmes, or where a consumer has made prepayments for goods, or where a consumer is issued a retail credit note. Do they also obtain a preferential status or is the category becoming too wide?

Recommendation 26:
Place a six month limit on the preferential claims for amounts unpaid to the Commissioner of Inland Revenue and the Collector of Customs.

DISAGREE

We believe that if a time limit is to be placed on preferential claims for Inland Revenue and Customs, that time limit should be at least one year prior to liquidation, and where it is a Court liquidation, at least one year prior to the making of the application to liquidate the company, together with the period to when the order to put the company into liquidation is made.

Inland Revenue (IR) accounts for the largest proportion of claims in liquidations, and therefore will be most significantly affected by this proposed change.

Comment on IR's duties and powers

Prior to making an application to liquidate, IR may work with the stakeholders of a company to try and enter into an arrangement for tax liabilities owed. A successful arrangement may enable the company to continue to operate long term. However, should a six month limit be placed on preferential claims, IR would be incentivised to liquidate the company as quickly as possible to maintain their preferential status rather than work with the stakeholders.

IR is also an involuntary creditor, and, unlike trade creditors, does not have the option of cutting off supply to delinquent companies. This leaves IR without the power given to trade creditors, resulting in IR payments being the first to be overlooked when a company has cash flow issues.

Comment on the timing and filing of tax returns

For IR to make the determination that a company should be petitioned for liquidation, it requires information from unpaid tax returns to support its application.

Most companies are on a two-monthly filing period for GST, which means in six months this would only cover tax for two GST periods (given that returns are due for filing in the following month). If standard business practices applied, it would be abnormal for a trade creditor to apply to liquidate a customer after only two periods of supplies being overdue, so IR should not be held to a different standard when they are an involuntary creditor.

Additionally, some companies may only file and pay every six months, so IR would be tasked with applying for liquidation after one unpaid return, or lose their preference by waiting to see if a pattern emerges.

The above examples only apply if the company is filing on time and accurately, and for some of the insolvent liquidations we see, the company has stopped filing its PAYE and GST returns quite some time before it is placed into liquidation. Therefore, the onus is on IR to calculate the tax owing, which may take time.

Comment on the Australian Tax Office (ATO)

While the report states that the ATO lost its preferential status in the 1990's, the report is silent on the fact that this loss was to a large extent mitigated by the ATO having the power to issue a director penalty notice ("DPN"), which finds directors personally liable for unpaid pay as you go (PAYG) withholding obligations.

A director is provided with a powerful incentive to place a company into voluntary liquidation or voluntary administration within a short period of time of a DPN notice being issued in order to avoid personal liability. Here, the report proposes the placing of a substantial time limit on the IR's preferential status without proposing any commensurate mitigating powers, such as DPNs.

Comment on Customs

In our experience the proportion of insolvent liquidations which have unpaid Customs duties is much less than the proportion which have unpaid taxes. However, we suggest that if it is necessary to place a time limit on the Customs preference, that time limit should also be at least one year and not the six months proposed.

Recommendation 27:
Amend section 167 of the Tax Administration Act 1994, such that all claims for PAYE provable in a liquidation are to be paid in accordance with Schedule 7 of the Companies Act 1993.

AGREE

We agree that this anomaly needs to be amended so that PAYE liability which arises prior to the date of liquidation is treated the same as other creditor claims which arise prior to the date of liquidation.

Recommendations – Receiverships Act 1993

Recommendation 28:
Clarify that the priority for administrators' fees and expenses continues to apply when a company is both in receivership and administration.

AGREE

Given the responsibility placed on an administrator we agree that it is appropriate that priority should be given to the payment of their fees and expenses when the company is also in receivership, in respect of the type of recoveries as referred to under section 239 ADM of the Act.

Recommendation 29:
Align the priority in section 30(2) in respect of the assignment of accounts receivable with section 153(2)(b) of the Property Law Act 2007.

AGREE

We agree that any attempt to clarify and remove ambiguity is appropriate.

Recommendation – Statistical data

Recommendation 30:
The Registrar of Companies should collate and publish information from reports lodged by insolvency practitioners.

AGREE

We agree that improved data collection would be beneficial to assess how New Zealand's insolvency sector is performing. This will also help support the licensing regime as proposed under the first IWG Report. The World Bank publishes international comparisons on the Ease of Doing Business. Part of its rankings include Insolvency, which has a number of composite areas which are considered. The Registrar may want to consider aligning reporting with those areas to assist ease of transparency and comparison.

We also agree that complaints statistics should be published. An important part of having a licensing regime is transparency and accountability.

Chapter 6 – Changes to the Insolvency Act 2006

Recommendation 31:
Make changes equivalent to recommendations 1-13, 15, 17 and 24-27 to the Insolvency Act 2006.

AGREE

Unless there is a compelling policy reason to differ we agree that steps should be taken to ensure the provisions of the Insolvency Act 2006 are consistent with any changes made to the Act. The regime serves the same purpose, just for different legal entities.