

Insolvency Law Review

**Business Rehabilitation:
Discussion Document**

May 2002

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Submissions

Purpose of the Discussion Document

1. This discussion document has been prepared by the Ministry of Economic Development in consultation with other government agencies. The document is the latest public document on the topic of business rehabilitation, which is one issue that is being considered as part of the Government's review of insolvency law.
2. This document follows three earlier documents – David Brown's report to the Ministry of Economic Development, *Corporate Rescue* (November 2000); the Law Commission's study paper, *Insolvency Law Reform: Promoting Trust and Confidence* (May 2001); and an economic review of the Law Commission's paper by the consultancy Charles Rivers Associates (Asia Pacific Ltd) (June 2001). This document and the three earlier reports are all available on the Ministry of Economic Development web site at: www.med.govt.nz/ri/insolvency/review.html.
3. Public consultation on those earlier documents undertaken in 2000/2001 has been inconclusive. In particular, there was not widespread support for the targeted rehabilitation regime outlined in the Law Commission's paper. The Ministry therefore considers that further policy development would be aided by seeking stakeholders views on possible design options for a new business rehabilitation regime. This document therefore aims to provide a broad outline of the policy options available for a possible new business rehabilitation regime and the design issues relating to those options.

Making a Submission

4. The Ministry invites written submissions on the issues and questions raised in this discussion document from any interested parties. The closing date for submissions is **Friday, 19 July 2002**. After submissions have been received, they will be evaluated, and further comments as required will be obtained from submitters before the Ministry develops recommendations for the Government to consider on the issue of business rehabilitation.
5. Submissions should be sent either by email in Microsoft Word version 2000 or lower to darren.baars@med.govt.nz, or in hard copy to:

Business Rehabilitation
Attention: Darren Baars
Ministry of Economic Development
PO Box 1473
WELLINGTON
Tel: 04-470 2313
Fax: 04-471 2658

Official Information Act and Privacy Act Requirements

6. The contents of submissions provided to the Ministry in response to this discussion paper will be subject to the provisions of the Official Information Act 1982 and the Privacy Act 1993. If the Ministry receives a request for information contained in a submission, it would be required to consider release of the submission, in whole or in part, in terms of the criteria set out in these Acts.

7. In providing your submission, please advise if you have any objections to the release of any information contained in your submission, and if you do not object, the parts of your submission you would wish withheld and the grounds for withholding that information.

Disclaimer

8. Any statements made or views expressed in this discussion document are those of the Ministry of Economic Development and do not reflect Government policy. Readers are advised to seek advice from a qualified professional before undertaking any action in reliance on the contents of this discussion paper. While every effort has been taken to ensure that the information set out in this paper is accurate, the Crown does not accept any responsibility whether in contract, tort, equity or otherwise for any action taken, or reliance placed on, any part, or all, of the information in this paper or for any error in or omission from this paper.

Executive Summary

9. The Ministry's consultation on business rehabilitation conducted in 2000/2001 was inconclusive. This discussion document seeks to obtain further and more precise information from stakeholders so that it can be used as a basis for providing policy advice to the Government on the issue of business rehabilitation.

10. This document is divided into four parts, with the discussion starting at a broad level and becoming more specific part by part. The issues discussed in Part C and Part D are predicated on certain answers being given to questions raised earlier in the paper. This approach is being used in an attempt to gain information about specific issues that we anticipate would need to be addressed if the Government agreed that New Zealand should adopt a new approach to business rehabilitation.

11. Part A and Part B of the paper describe:

- the nature of business rehabilitation;
- the main reasons for and against having rehabilitation processes;
- the problems with the existing New Zealand law; and
- business rehabilitation in other jurisdictions.

12. Part B concludes that New Zealand's business rehabilitation law is rarely used and seems to serve little real purpose either in terms of salvaging businesses that are essentially sound, but may have got into difficulties, or increasing returns to creditors.

13. Part C identifies and discusses two options for dealing with the substantive and procedural issues with the New Zealand law as identified in Part B.

14. Option One is a modified status quo, outlining changes that could be made to encourage the use of the existing regime. In particular, it canvasses the possibility of introducing an automatic stay on debt recovery measures that binds unsecured creditors.

15. Option Two canvasses the possibility of introducing a voluntary administration regime modelled on the Australian law. The key feature of this option is the inclusion of a stay that binds all creditors.

16. The main disadvantage associated with Option One is that it may not be that effective in addressing the objectives of business rehabilitation. In many instances of business insolvency there is often little, if anything, to be distributed among unsecured creditors. Hence, the automatic stay may simply have the effect of delaying formal insolvency rather than being a more accessible pathway towards business rehabilitation.

17. Option Two may provide a way of promoting business rehabilitation in a much wider range of circumstances. The main benefit of a rehabilitation regime with a stay that binds all creditors (including secured creditors) is that it could allow economically

viable businesses to continue rather than liquidate, thereby increasing overall returns to creditors in those cases. The other benefits of business rehabilitation are that it could:

- Preserve value in the business as a going concern for all stakeholders including creditors, employees, suppliers and owners;
- Minimise the loss for those who deal with the insolvent business in having to re-establish business relationships with another entity, e.g. employees, creditors and suppliers;
- Reduce the number of formal insolvencies and associated costs e.g. voidable transactions and the disposal of assets; and
- Force reluctant debtors and creditors to communicate and explore whether rehabilitation of the business will maximise returns to creditors.

18. The risks associated with a rehabilitation procedure that binds all creditors are that it could be used:

- To impede the business failure element of the dynamic process of business creation;
- By debtors to defeat the legitimate interests of creditors;
- By unsecured creditors at the expense of secured creditors.

The paper identifies possible ways of mitigating these risks.

19. Part D of the paper is based on the assumption that if a new approach to business rehabilitation is warranted then the Australian voluntary administration regime is likely to be the preferred model. It identifies a number of design issues, describes how Australia deals with each of those issues and considers whether there are reasons for departing from the Australian approach.

Part A - Background

What Is Business Rehabilitation?

20. In its widest sense, a business rehabilitation regime provides an alternative to liquidation under which a debtor company or individual can enter into a binding compromise or arrangement with its creditors and keep trading, with a view to maximising returns to creditors.

21. In its advisory report to the Ministry of Economic Development, *Insolvency Law Reform: Promoting Trust and Confidence*, the Law Commission noted, from the work of the United Nations Commission on International Law (UNCITRAL) that:

“(business rehabilitation) schemes in other jurisdictions typically contain the following elements:

- Voluntary submission by an entity to the process, which may or may not involve judicial proceedings and judicial control or supervision;
- Automatic and mandatory stay or suspension of actions and proceedings against the property of the entity affecting all creditors for a limited period of time;
- Continuation of the business, either by existing management, an independent manager or a combination of both;
- Formulation of a plan which proposes the manner in which creditors, equity holders and the entity itself will be treated;
- Possibly the judicial sanction of an accepted plan; and
- Implementation of a plan.”¹

22. Many different terms are used to describe the general concept of a process of either rehabilitating or putting together a plan to rehabilitate a business entity. These include “corporate rescue”, “corporate rehabilitation”, “voluntary administration”, “business re-construction” and “company re-organisation”. For the purpose of consistency and to avoid confusion the term used throughout this paper to describe the general concept of a legislative rescue regime for companies is **business rehabilitation**. Otherwise, all mechanisms that currently exist in New Zealand and in other jurisdictions are referred to by their actual name.

What Are the Benefits Ascribed to Business Rehabilitation?

23. There are a number of potential benefits of having a regime that facilitates the continuation of a business rather than its liquidation. These include:

¹ New Zealand Law Commission. *Insolvency Law Reform: Promoting Trust and Confidence*. NZLC SP11 (Wellington: New Zealand Law Commission, 2001), paragraph 183.

- The preservation of the economic value of the company as a going concern for all stakeholders in that business;
- Minimising the loss for creditors, including employees, and others who deal with the insolvent company from having to re-establish relationships with another entity; and
- A business rehabilitation procedure can also provide for a more measured distribution of the assets of a company if it does eventually fail, thereby increasing returns to all creditors.

24. There are, however, also potential costs associated with such a regime. These include:

- An increase in the cost of credit as a result of the inability of creditors to enforce contractual rights during a stay on proceedings against the company;
- The cost of allowing a company to trade on which, in some cases, may further erode its value; and
- The financial costs to the company of the administration of a business rehabilitation procedure.

25. Most international research concerned with business rehabilitation focuses on the use of regimes and levels of returns to creditors. These studies indicate that creditors receive a range of levels of returns under business rehabilitation. In Australia for example, empirical studies provide evidence that eventual returns to creditors after voluntary administration are slightly higher than returns after company wind-ups. These Australian studies suggest that voluntary administration produced an average return to creditors of between 21.5% to 10% compared to the average return of 7.35% in wind-ups.²

26. The design of a business rehabilitation procedure can act to maximise the instances where, in relation to particular companies, the benefits of rehabilitation will outweigh the costs involved. The discussion of options and design features for a business rehabilitation regime presented later in this paper includes consideration of the extent to which those features identified could maximise the benefits and minimise the costs of a regime.

Business Rehabilitation in Other Jurisdictions

27. Business rehabilitation regimes have been previously adopted in a number of other developed countries. In recent years there has been a growing international trend towards countries reviewing the effectiveness of their existing business rehabilitation procedures and adopting new regimes.

² These studies are discussed in S. McColl, "Voluntary Administrations: How Well Are They Working?" *Australian Journal of Corporate Law*, LEXIS 2 (2001): 23-24.

Australia

28. In 1992 Australia introduced a voluntary administration procedure in its Corporate Law Reform Act 1992. Until 1992 there had been a rescue procedure known as “official management”, which required a high threshold of proof that the company could be rescued.

29. Administration is “voluntary” in Australia since it is the company or its directors that usually initiates the procedure. The procedure does not require any initial court hearing. Secured creditors with charges over all, or substantially all, of the assets may initiate appointment of an Administrator. An automatic stay of 21 or 28 days is imposed and the company is placed in the hands of a qualified administrator who must be a registered state-licensed liquidator. The Australian voluntary administration procedure is explained in more detail in Appendix I, Appendix II and Part D of this paper.

The United Kingdom

30. In 1985 the United Kingdom made provision for two forms of rescue procedure, which are interrelated. Following the Cork report in 1982, an administration order was conceived as filling the gap where there was no secured creditor with power to appoint a receiver over all or most of the company’s undertaking. Receivers were generally seen to be doing a good job in ensuring survival or sale of viable businesses as going concerns, however the duties of such receivers were slightly increased in 1985 to make them more accountable to general creditors.

31. In the United Kingdom the administration order is a court order which can be made on various grounds, by petition of the directors, the company or creditors (in most cases). In addition to satisfying the court that the company is, or is nearly, insolvent, it has to be demonstrated that one or more of four purposes would be served by the order. One purpose relates to the other new procedure introduced in 1985, the “Company Voluntary Arrangement” (CVA). This was conceived as a simple form of compromise procedure whereby a debtor company could put a proposal to creditors, supervised by an independent practitioner who would report to court on the viability of the proposal. The other purposes of an administration order are the survival of the company as a going concern, an “old style” court sanctioned composition or arrangement and lastly, if it can be shown that there is likely to be a better realisation of assets than if a liquidation occurred.

32. The CVA is very similar to Part XIV of the New Zealand Companies Act 1993, though without the need for class meetings. However, unlike the procedure introduced at the same time for individuals in the United Kingdom, the CVA does not have a moratorium against creditor action attached to it.

33. Within the United Kingdom legislation the court has discretion whether or not to make an administration order, and will expect a report by an independent insolvency practitioner (usually the proposed administrator) to be filed. A person entitled to appoint a receiver who would have control over all or most of the company’s assets can effectively “veto” the administrators appointment by appointing a receiver in a five day decision period, similar to the ten day period in Australia. The moratorium imposed from the time of an administration petition is quite large compared to that on

liquidation, extending to all proceedings, enforcement of security and other legal processes. However, it is not as wide as the moratorium in the United States (see below).

The United States

34. The United States formal rescue procedure contained in Chapter 11 of the Federal United States Bankruptcy Code is the oldest of the formal rescue regimes discussed here, being enacted in 1978. Chapter 11 has now become the major insolvency procedure in preference to Chapter 7 liquidation (there are various specific procedures under other Chapters for agricultural industry and municipalities for example). Chapter 11 filings at court trigger an extremely wide automatic stay under Section 362 of the Code. The conversion process between reorganisation and liquidation proceedings is relatively straightforward, unlike in jurisdictions such as the United Kingdom. In practice, most Chapter 11 filings are voluntary.

35. The distinguishing feature of Chapter 11 over many English-speaking jurisdictions' procedures, other than Canada, is that there is no automatic appointment of a professional "outsider" to any management role. The company retains control and management functions, subject to a raft of duties and powers which distinguish it from the corporate entity pre-filing. The powers include the ability to challenge preferences and unperfected security interests. The duties are fiduciary in nature. The court must sanction any disposals outside the ordinary course of business. In addition, there is provision for the appointment of a trustee and/or an examiner by the court, but this is rare, such as in cases of fraud. The examiner would usually be appointed at the request of creditors to conduct an investigation as to the viability of reorganisation, or where the assets are over \$5 million, but the functions of the examiner are largely at the discretion of the court.

36. Within the United States regime there is no requirement that an entity be insolvent for Chapter 11 to be initiated, so that the automatic moratorium triggered by filing can be used tactically. However, it has to be borne in mind that in some cases filing for reorganisation may be a genuine attempt to deal with anticipated insolvency and might follow from a major philosophical commitment to the concept of "fresh start" which seems to extend to corporate as well as individual debtors, and to pre-date the 1978 reforms. This means that once a debtor files, the wide moratorium protects the debtor from almost any creditor action for a relatively lengthy "exclusivity period" of 120 days during which the debtor is supposed to put together a reorganisation plan. The court may extend this period of exclusivity.

37. In the United States regime the debtor must put any reorganisation proposal to class meetings of creditors, so that all classes of creditors whose rights have been impaired by the proposal get a chance to vote. The debtor generally has at least 60 days after the 120 day period in which to negotiate. Dissenting classes after voting can be "crammed down", in other words bound by the scheme despite voting against it. However, this happens rarely in practice. In addition, the plan has to be approved by the court, which applies a number of fairness criteria and has to be satisfied that the scheme is "feasible" and that individuals who dissent will receive at least as much as they would on a liquidation.

Canada

38. Along with Australia, Canada has passed legislation designed to avoid most of the problems of delay and abuse possible under Chapter 11 in the United States, yet avoiding the costs involved in the United Kingdom approach.

39. The main features of the Canadian Bankruptcy and Insolvency Act procedure are that a debtor may file either a proposal for a reorganisation (for example if the company is already in receivership), or a notice of mere intention to file one (creditors cannot file for a debtors reorganisation, unlike in the United Kingdom and Australia). A wide moratorium against creditor action is triggered for an initial 30 day period. However, a trustee has to attest to creditors the accuracy of the debtors cash flow projections. The trustee's role is deliberately "light-handed", though he must report to the official receiver any "material adverse change" since the original filing. The court is not involved in initiation of the procedure, but where more than light monitoring is required, may be involved in defining the trustee's powers that can be quite wide.

40. In the Canadian regime there is a very strict timetable during which the debtor must effect a proposal and, if it is not approved by creditors, automatic liquidation follows. While there is some judicial flexibility for extensions of the moratorium period, there is a maximum cumulative period beyond which the court cannot go under any circumstances.

41. Unlike the situation in the United Kingdom and Australia, in Canada a secured creditor who wishes to appoint a receiver over all or most of the company's business and assets, must give the debtor company ten days notice, during which time the company can file for protection. If the charge holder is genuinely concerned that assets may disappear in that time, it can apply to the court for the appointment of an interim receiver to safeguard the assets.

International Trends and Adopting Best Practice

42. As previously stated, there has been an increasing trend internationally towards countries reviewing and modifying their existing business rehabilitation regimes or adopting new regimes. The 1998 financial crisis in South-East Asia has, with the assistance and encouragement of organisations such as the World Bank and UNCITRAL (the United Nations Commission on International Trade Law), triggered the review and development of insolvency laws in many jurisdictions.

43. As can be seen from the discussion above, the business rehabilitation regimes of other countries are all in different stages of development, with arguably the best developed regimes being those of Canada and Australia.

44. If New Zealand is to review its current business rehabilitation laws and develop a new regime, then it is important that the new regime conforms to international best practice in the area. This is because overseas investors may be deterred from investing in New Zealand if they perceive differences between New Zealand's business rehabilitation regime and that of other jurisdictions. Co-ordinating with the Australian approach to business rehabilitation would also mean that it would be easier and less costly to conduct rehabilitations for the growing number of businesses that operate on both sides of the Tasman.

Linkages with Statutory Management

45. Stakeholders have previously noted the linkages between business rehabilitation and the existing statutory management procedures contained in the Corporations (Investigation and Management) Act 1989 (the "CIMA").

46. These existing statutory management procedures enable the Governor General in Council to replace the management of a company with a statutory manager in certain situations. Currently, the statutory management procedure is commenced by Order in Council on the advice of the Minister of Commerce. The Minister can only do this on the recommendation of the Securities Commission. In practice, decisions are normally made on the recommendation of the Securities Commission following an investigation by the Registrar of Companies.

47. The Securities Commission may recommend that a corporation be placed in statutory management:³

- To preserve the interests of stakeholders, creditors, beneficiaries, or the public interest;
- To enable the corporation's affairs to be dealt with more quickly or in a more orderly way; or
- If they believe that the corporation was acting fraudulently or recklessly.

48. The CIMA only applies where the public interest or the interests of members, creditors or beneficiaries of a corporation cannot be protected under the Companies Act 1993 or in any other lawful way.⁴

49. Statutory managers are granted wide powers under the CIMA to manage the corporation and an extensive moratorium is imposed on claims against the corporation.

50. If a new business rehabilitation regime were introduced, the potential scope of the application of statutory management will be arguably reduced because there would be an extension of member, creditor and beneficiary interests under the Companies Act in accordance with section 4 of the CIMA.

³ Section 4 of the Corporations (Investigation and Management) Act 1989.

⁴ Ibid.

Part B - Should New Zealand Adopt a Business Rehabilitation Regime?

Economic Development Policy Objectives

51. In February 2002 the Government released its policy framework for economic transformation in New Zealand - *Growing an Innovative New Zealand*. This framework forms the broader policy context in which the Government will consider the possibility of New Zealand adopting a new business rehabilitation regime.

52. *Growing an Innovative New Zealand* states that the next phase of New Zealand's economic development must be characterised by innovation. We must become a nation known internationally for our innovation, our creativity, our skills and our lifestyle. In order to fulfil this objective the Government is committed to working in all parts of the economy. *Growing an Innovative New Zealand* states that the Government intends to continue giving priority to maintaining the integrity of the economy by ensuring:

- A stable macroeconomic framework;
- An open and competitive microeconomy;
 - By improving the conditions for New Zealand businesses, including reducing compliance costs.
 - By providing programmes to help businesses grow.

53. A new business rehabilitation regime could arguably assist in the Government meeting these objectives by providing an opportunity for some businesses verging on insolvency to develop a plan to trade on, rather than liquidate. Business rehabilitation could therefore in some instances improve the overall operating environment for New Zealand businesses and could enable New Zealand business to grow and be internationally competitive. This would have social and economic benefits and would foster economic development.

Does the Current Law Achieve Business Rehabilitation Outcomes?

Description of the Current Law

54. Part XIV (Compromises with Creditors) and Part XV (Approval of Arrangements, Amalgamations, and Compromises by Court) of the Companies Act 1993 allow companies to enter into agreements with their creditors (including the continuation of businesses) as an alternative to liquidation. These legislative provisions form New Zealand's current business rehabilitation regime.

Part XIV of the Companies Act 1993 (Compromises with Creditors)

55. The major corporate rehabilitation procedure in New Zealand is contained in Part XIV of the Companies Act 1993. The key elements of the current business rehabilitation regime set out in Part XIV of the Companies Act are:

- Either a company's directors, its receiver or liquidator, or a shareholder or creditor of the company (with leave of the Court) may propose a compromise between a company and its creditors;
- The proponent of the compromise must call a meeting and provide detailed information to the creditors about the proposal and its effect. Pending the meeting there is no automatic stay, although one may be sought from the Court. Such a stay cannot be ordered against secured creditors and is only available from a date that is not earlier than the date on which the notice of the proposed compromise was given, and not later than 10 working days after the date on which notice was given of the result of the voting on it. No stay can be obtained to enable a proposal to be prepared;
- If different classes of creditors have different interests, it is usually necessary to hold separate meetings for each class; and
- A compromise is binding on all creditors (including secured creditors) that received notice of the proposal if 75 percent at each meeting vote in favour (unless there is provision in the compromise for classes of creditors to be separately bound). There is no need for the Court to approve the compromise, however, a creditor may apply to the Court for relief on certain prescribed grounds (insufficient notice, irregularity in obtaining approval, unfair prejudice).

Part XV of the Companies Act 1993

56. Part XV of the Companies Act 1993 permits an application to be made directly to the Court by the company, a shareholder, or a creditor for an order that a compromise is binding on the company and "on such other persons ... as the Court may specify ... on such terms ... as the Court thinks fit."⁵ The legislation gives no further direction as to how the Court should exercise its direction, though some guidelines have been developed through subsequent case law.

57. Part XV gives the Court power to make initial orders regarding the provision of information and reports to shareholders and the calling of meetings. It is usually appropriate for such orders to be made before considering whether a final order should be made.

Receiverships

58. A receiver may be appointed in respect of the property of a person by, or in the exercise of a power conferred by, a deed or an agreement to which that person is a

⁵ Section 236(1) of the Companies Act 1993.

party. The receiver acts primarily in the interests of the creditor who appointed him/her. Their purpose is not to act in the collective interests of creditors.

59. Receivership can work as a rescue procedure where it is in the interests of a debenture holder to maintain the business as a going concern. The receiver acts to recover debenture holders debt as quickly and expeditiously as possible at lowest cost. Once this is done the receiver's role is complete. Post-receivership the debtor is often on the brink of liquidation, so in effect, receivership asserts the interests of the debenture holder above those of other creditors.

Problems with the Current Legal Regime

Individual v Collective Creditors' Interests

60. The lack of an easily initiated stay on all debt recovery measures effectively inhibits business rehabilitation except in those few cases where all parties agree. This means there are situations where a minority of creditors, in seeking to recover their debts, can put their interests ahead of the majority. These creditors do not factor the external cost or loss of value to creditors overall of not continuing the business as a going concern, in part or as a whole, into their decision to proceed with individual debt recovery.

High Transaction Costs

61. The Part XIV procedure has not been greatly used.⁶ Anecdotal evidence suggests it is not well understood and, in the absence of an automatic stay, rehabilitation may be defeated by the high cost of defending actions by creditors pre-proposal.

62. The transaction costs associated with the current procedures include not only the costs of a proceeding, but also the costs incurred by the promoter of a proposal in defending the debtor business against actions by individual creditors seeking to recover their debts. The expense of seeking to have statutory demands set aside will often be enough to deter an individual creditor from acting for the collective benefit of all creditors and seeking rehabilitation. Stakeholders have previously noted current use of the statutory demand process in this way, especially in the case of SMEs (Small to Medium Size Enterprises) with a large number of unsecured creditors.

Problems with Part XV Companies Act

63. The main reasons why the current procedure in Part XV of the Companies Act 1993 is used infrequently appear to be:

- The need to apply to the Court for a stay (thereby imposing costs and time delays);
- A stay is only available once a proposal is developed and distributed;

⁶ New Zealand Law Commission. *Insolvency Law Reform: Promoting Trust and Confidence*, paragraph 196.

- A stay cannot bind secured creditors.

64. At present, a stay is only available from the date the notice of the proposed compromise was given. Where it would be the most effective would be during the period where the proposal is being developed.

Questions for Submissions

1. Do you agree with this assessment of the problems with the current Companies Act provisions?
2. Can you identify any other problems with the current business rehabilitation regime not covered in this section?

Rehabilitation v Liquidation

65. Business rehabilitation law is about minimising the costs of failure.⁷ The key issue regarding business rehabilitation in New Zealand is whether, in the absence of an informal workout between the concerned parties, the current insolvency law regime provides a viable alternative to liquidation for a failed business.

66. As noted above, the lack of a general stay on all debt recovery measures effectively inhibits business rehabilitation under the current legislative procedures except in those few cases where all parties agree. Therefore, in effect, the current legislation promotes liquidation.

67. The advantages of a regime which favours liquidation are that it:

- Encourages individual creditors to monitor debtors and to act early when repayment issues arise;
- Encourages the movement of resources from poorly performing management and firms to more efficient firms; and
- Is in many cases shorter, administratively cheaper and simpler than rehabilitation.

68. The main benefit of a rehabilitation regime with a stay or moratorium that binds all creditors (including secured creditors) is that it could allow economically viable businesses to continue rather than liquidate, thereby increasing overall returns to creditors in those cases. The other benefits of rehabilitation are that it could:

- Preserve value in the business as a going concern for all stakeholders including creditors, employees, suppliers and owners;

⁷ David Brown, *Corporate Rescue: Report for the Ministry of Economic Development* (Wellington: Ministry of Economic Development, 2000), 5.

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- Minimise the loss for those who deal with the insolvent business in having to re-establish business relationships with another entity, e.g. employees, creditors and suppliers;
- Reduce the number of formal insolvencies and associated costs e.g. voidable transactions and the disposal of assets; and
- Force reluctant debtors and creditors to communicate and explore whether rehabilitation of the business will maximise returns to creditors.

Questions for Submissions

3. Do you consider that the current regime favours liquidation over rehabilitation?
4. Keeping in mind the Government's economic development objectives, do you consider the benefits of favouring liquidation over rehabilitation outweigh the costs?

Part C - Options for Addressing Problems Identified with Current New Zealand Law

Problems with the Current Law

69. The key problems identified in Part A with the current regime can be summarised as:

- Individual creditors' place their interests ahead of the collective interests of creditors; and
- There are high transaction costs involved in using the current regime.

Options for Addressing Problems Identified

70. This section discusses two options for addressing these issues:

- Amendments to strengthen the current law; and
- The adoption of a more comprehensive business rehabilitation regime, which would include a stay against actions of secured creditors.

Option One - Amendments to Strengthen the Current Law

71. This option involves retaining the status quo (i.e. no stay against secured creditors), but introducing an automatic stay against unsecured creditors.

72. Stakeholders have suggested that Part XIV of the Companies Act 1993 could be strengthened to reduce opportunities for a creditor minority to defeat the interests of the majority. At present the Part XIV moratorium is insufficient to prevent creditors from taking action against the debtor to the detriment of creditors overall. In many instances, it will be too costly to defend these actions. Part XIV could be amended to include an automatic rather than a court-ordered stay on actions by unsecured creditors.

Option Two - Adoption of Business Rehabilitation (Including an Automatic Stay against Actions of Secured Creditors)

73. As noted above, a regime with a mandatory stay preventing secured creditors from taking recovery action during the development of a rehabilitation plan may maximise returns to all creditors. A stay of this type is likely to result in greater use of the business rehabilitation procedure and possibly a higher percentage of successful rehabilitations of economically viable companies.

74. While the continued use of secured assets is likely to be key to the successful rehabilitation of a business, secured creditors could retain the right to reject a proposal through voting at the completion of the stay. Secured creditors would also retain the right to enforce their securities post-proposal.

Analysis of Options

75. Both options would reduce transaction costs by reducing the need for court involvement before a stay against actions against the company can be implemented.

76. The underpinning assumption of the current law is that where rehabilitation is most viable and will provide the greatest returns to creditors, that secured creditors have both the commercial judgement and incentives to support the rehabilitation. There is in many cases an obvious financial incentive for secured creditors to pursue rehabilitation where an asset realisation is worth less than the value of the asset as part of a going concern. In informal workouts the “buy-in” of secured creditors is critical to the success or otherwise of any arrangement, as the realisation of the security may effectively prevent any possibility of rehabilitation. The key issue is whether a legislative stay on secured creditors will result in a greater number of successful rehabilitations of economically viable companies and therefore provide increased returns to creditors.

77. The potential advantage of a stay against actions by secured creditors is that it could, if implemented properly, reduce the cost of credit by increasing returns to all creditors. However, the increased contractual uncertainty faced by secured creditors may have the opposite effect on the cost of credit. Rehabilitation of businesses may, however, be encouraged as debtors and administrators will be able to focus on the preparation of a rehabilitation proposal for creditors knowing that all individual recovery actions are stayed.

Questions for Submissions

5. Do you have any evidence or view that affirms or rejects the assumption that under current New Zealand law creditors will have both the commercial judgement and incentives to support rehabilitation where it is most viable?
6. Do you believe that the interests of the business and creditors as a whole would be enhanced by introducing a more comprehensive business rehabilitation regime that includes a stay on secured creditors?

Part D - Design Issues

Adoption of the Australian Approach

78. The Australian approach to business rehabilitation, voluntary administration, is outlined in Appendix I of this paper. If New Zealand were to adopt a business rehabilitation regime which includes an automatic stay against secured creditors, there are strong reasons to consider adopting the Australian approach to business rehabilitation or parts of that approach.

79. There are a significant and increasing number of firms which conduct business on both sides of the Tasman. As capital markets become more integrated and as barriers to the supply of goods and services from New Zealand to Australia and vice versa are reduced, it has become more common for firms to have both assets and creditors in both countries.

80. Because of the increasing incidence of trans-Tasman and international companies and transactions, and in order to encourage greater trans-Tasman activity, it is important that New Zealand has insolvency laws that minimise the transaction costs for a company operating in both jurisdictions.⁸

81. Where a company does operate in both Australia and New Zealand, a rehabilitation regime that applies in one country and not the other is unlikely to fully achieve its objectives. For example:

- A creditor is likely to be able to circumvent the stay by taking action in the other country, thereby preventing the company from trading on as a going concern; and
- If the stay in one country begins at a different time from the stay in the other or ends earlier, the effective length of stay will be limited to the period where the stay is operative in both countries.

82. In recognition of the benefits of co-ordinating Australian and New Zealand law in this area, the discussion of design issues in this paper reflects a presumption in favour of following the Australian approach, unless there are good reasons to take an alternative approach.

Question for Submissions

7. If New Zealand were to adopt a new business rehabilitation regime then should we co-ordinate with the Australian voluntary administration procedure? What further reasons for and against co-ordinating with the Australian approach can you think of?

⁸ This is also consistent with the objectives of the Memorandum of Understanding on the Co-ordination of Business Law that was signed between the New Zealand and Australian Governments in August 2000.

Business Rehabilitation Design Issues

83. The previous section of this paper noted that if New Zealand were to reform its business rehabilitation regime along the lines of one of the two broad options previously stated, then there would be benefits in adopting the Australian approach. Assuming that New Zealand might want to reform its business rehabilitation regime and adopt the Australian approach, the next section of the paper identifies the other important issues that would need to be considered in the design of a business rehabilitation regime and for each issue:

- Describes the Australian approach;
- Assesses the viability of adopting the Australian approach; and
- Considers whether there are any reasons to adopt an alternative approach.

Safeguards for Creditors

84. A key risk of a stay against secured creditors is the potential for an abuse of the procedure by the owners and/or the directors of a business. For example, the stay might be used to delay an inevitable liquidation with funds and assets expended or transferred defeating the interests of creditors. However, the potential for this can be minimised by certain design features.

85. In Australia, major secured creditors have the ability to enforce their security within 10 days of the initiation of an administration.⁹ This prevents shareholders from using the procedure to defeat the interests of those creditors.

86. The Court also has the power to make such orders that it thinks fit in relation to a particular company. For example, if the Court is satisfied that the administration should end because provisions of Part 5.3A of the Act are being abused, it may order the administration is to end.¹⁰ An order may be made on the application of various interested people, including a creditor. The Court is also able, on the application of a creditor or ASIC (the Australian Securities and Investments Commission), to make any order it thinks necessary to protect the interests of a company's creditors while the company is under administration.¹¹ In addition, creditors have the ability to apply to the Court for the removal of an administrator.¹²

87. The Australian safeguards provide a balance between the interests of an efficient administration and the interests of secured creditors. While there was some initial concern about the ability of major secured creditors to thwart administration and

⁹ Section 441A of the Corporations Act 2001.

¹⁰ Section 447A of the Corporations Act 2001.

¹¹ Section 447B of the Corporations Act 2001.

¹² Section 449B of the Corporations Act 2001.

rescue attempts,¹³ to date, there appears to be little evidence that this has occurred. A recent study reported that 80% of the sample companies in administration were subject to substantial charges, but that the vast majority of chargees allowed the administration to proceed.¹⁴

88. There are no other features unique to New Zealand that would appear to rebut the presumption in favour of adopting Australian law in this area.

Question for Submissions

8. Do you consider that the Australian safeguards of the interests of creditors are sufficient? Would you support the adoption of these safeguards in a New Zealand business rehabilitation procedure? Why or Why Not?

Initiation

89. A business rehabilitation regime will generally provide for the process to be initiated in one of two ways:

- By filing of notice by a permitted party (resulting in an automatic stay of proceedings by creditors); or
- By application, generally, to a court (which will decide on defined criteria whether a stay should be imposed).

90. The stay will vary accordingly, being either:

- *Automatic* (avoiding the need for a court application and the attached costs in time and expense); or
- *Discretionary* (which while more costly, will limit appointment of incompetent or “friendly” administrators who consciously act in favour of the debtor).

91. The Australian voluntary administration procedure is initiated by appointment of an administrator in one of three ways:¹⁵

- By a resolution of the board of a company;¹⁶

¹³ See, for example, K. Lightman, "Voluntary Administration: The New Wave or the New Waif in Insolvency Law?" *Insolvency Law Journal* Vol. 2 (1994): 59.

¹⁴ J. Routledge, "An Exploratory Empirical Analysis of Pt 5.3A of the Corporations Law (Voluntary Administration)" *Companies and Securities Law Journal*, 4 (1998): 7.

¹⁵ Section 435C of the Corporations Act 2001.

¹⁶ Section 436A of the Corporations Act 2001.

- By the holder of a charge over all or substantially all of the property where the charge is enforceable;¹⁷ or
- By a liquidator.¹⁸

92. The Australian regime has an automatic stay and does not require court proceedings to initiate the administration procedure.

93. The initiation of administration in Australia is usually by the company itself. The ability of the company to initiate the procedure has two benefits – it is less costly than a court-initiated procedure and it provides a mechanism for a company to address any financial issues itself, providing incentives for the company to disclose its financial distress at an earlier point. The key risk of this approach is a perception that the company is able to frustrate the interests of creditors by initiating the procedure. However, as outlined in paragraphs 86 to 88, other features such as the ability to enforce a major security or apply to the court for relief provide some balance between the respective rights of creditors and the company.

94. Another issue is whether the initial stay is automatic or discretionary. Having an automatic stay, as in Australia, would avoid the cost and time required for a court application to enter the rehabilitation process and appoint an administrator. An automatic stay does, however, increase the likelihood of abuse by the debtor as the initiation process is easier and the debtor has an increased opportunity to appoint a “friendly” administrator. These same issues are relevant in considering the ability to extend a stay (see below).

Questions for Submissions

9. Do you favour appointment of an administrator by a business, creditor or both? What are your reasons?
10. Do you consider that the reduced costs associated with an automatic stay outweigh the benefits of court involvement in the process?

Length of the Stay

95. The length of the stay against creditor action in Australia is 21 days. During this time the administrator must prepare a report for consideration at a meeting of creditors. However, this period is extended to 28 days if the administration begins on a day that is in December or is less than 28 days before Good Friday. The Court may also extend this period on application made within the 21 or 28 days (whichever is applicable).¹⁹

¹⁷ Section 436C of the Corporations Act 2001.

¹⁸ Section 436B of the Corporations Act 2001.

¹⁹ Section 439A of the Corporations Act 2001.

96. The New Zealand Law Commission has recommended a stay against secured and unsecured creditors of 14 days, with the ability to extend the stay for a further 14 days.²⁰ Previously, some stakeholders have suggested that 14 days is too short a period of time in which to prepare a realistic proposal.

97. The length of a stay should allow, within reason, for any necessary investigation and assessment by an administrator or other party to put together a viable rehabilitation proposal. The period allowed for the length of a stay must provide a balance between safeguarding the interests of creditors and providing adequate time for the debtor business and its administrator to construct a viable proposal.

98. One issue is that the information available at the initiation of the rehabilitation procedure to construct a financial profile of a debtor will vary considerably from case to case. In many instances, the debtor's current difficulties may be attributed to a history of inadequate accounts and financial statements. For such reasons there may need to be some flexibility in the regime to ensure a genuine assessment can be made of the viability of rehabilitation. This is a feature of the Australian regime.

Question for Submissions

11. Can you identify any reasons for departing from the Australian approach in terms of the length of the stay?

Procedure on Failure

99. A related matter to the length of the stay is to consider what should happen at the end of the stay period.

100. The Australian voluntary administration procedure provides flexibility for companies to swap between procedures. At the meeting of creditors to decide the company's future, creditors may resolve that:²¹

- The company execute a deed of company arrangement; or
- That the administration should end; or
- That the company be wound up.

101. One method to discourage abuse of the rehabilitation process would be to provide for the automatic liquidation of the debtor if, for any reason, the proposal were to fail. At present, under Part XIV of the Companies Act 1993, if creditors do not approve a proposal the company is presumed to be insolvent. If retained in any reform, however, this provision would discourage companies approaching insolvency to use the regime either at all or at least until the business was insolvent. The more incentives there are for debtors to face up to their debts early the greater the returns to creditors are likely to be. An alternative method might be to limit or disallow future

²⁰ See New Zealand Law Commission. *Insolvency Law Reform: Promoting Trust and Confidence*.

²¹ Section 439C of the Corporations Act 2001.

use of the rehabilitation regime by a business entity or its principals, or to seek court approval for an alternative action should the proposal fail.

102. As noted above, the purpose of a stay is to allow for required information to be gathered and assessed that is not readily available at the initiation of the procedure. This same information gap can apply to companies that enter the liquidation process. It is possible that during the course of a liquidation administration an assessment could be made that a company might be able to be rehabilitated.

103. As in the Australian regime, a reformed New Zealand regime could define the circumstances in which there could be a conversion from one process to the other and whether the stay would be available in such proceedings.

Question for Submissions

12. Do you consider that there are any good reasons for departing from the Australian procedure on the failure of an administration, which allows flexibility for a company to swap between procedures at the end of the stay period?

Control of Management

104. Another issue is deciding who should manage the business during the rehabilitation process.

105. In Australia Division 3 of Part 5.3A of the Corporations Act 2001 provides that the administrator has control of the company's business, property and affairs. They may carry on the business and manage the property and affairs or may terminate or dispose of any part of the business or property. They are also able to perform any function or exercise any power an officer of the company could perform.

106. While a company is under administration within the Australian regime a person cannot perform or exercise, or purport to perform or exercise a function or power, as an officer of the company except with the administrator's written approval.²² Generally, only the administrator is able to deal with a company's property.²³

107. An alternative approach is that the existing management could be completely replaced by a team of professional managers who are either representatives of the creditors or fully independent. While this would prevent any possible abuse of the rehabilitation procedure by the original directors there is a risk of a loss in efficiency as the new management take time and incur costs in becoming familiar with the business. On the other hand, if the business is insolvent this could be regarded as an indication that existing management are not up to the task. Proof of fraud by directors will also prevent their involvement in any rehabilitation process.

²² Section 437C Corporations Act 2001.

²³ Section 437D Corporations Act 2001.

108. The benefits of the Australian regime include that the existing management will be able to run the day to day business in the short term in the most cost-effective manner. However, it also provides for supervision and decision-making by an external party to prevent the potential for further losses by the company as a result of non-performing management.

Question for Submissions

13. Can you identify any reasons to depart from the Australian regime in respect of control of management? In particular, do you consider this regime creates the right balance between the continuing efficient operation of the business and the prevention of further losses to the company?

Post-Filing Finance

109. A related issue to the control of management is financing of the business during the period of the stay.

110. Under the Australian regime, Schedule 8A of the Corporations Regulations 1990 sets out provisions that must be included in a deed of company arrangement. These provisions include an express power for the administrator, for the purpose of administering the deed, to borrow or raise money, whether secured or unsecured, for any period on such terms as the administrator thinks fit. The effect of this provision is to allow the administrator to secure finance for the purpose of administering the provisions of the deed. As the administrator is able to obtain secured finance, the repayment of this debt would take priority over unsecured creditors.

111. In addition, an administrator is expressly able to perform any function and exercise any power that the company or any of its officers could perform or exercise if the company were not under administration.²⁴ This allows an administrator access to the company's existing finances.

112. The New Zealand Law Commission has proposed that management be prohibited from using existing company finances during the stay.²⁵ The Law Commission's proposed regime would therefore require new capital to be provided for the continuation of the business.

113. Prohibiting any use of existing finances may prevent any further losses to creditors but is likely limit the company's rehabilitation potential and therefore inhibit the use of the regime. This may be overcome by giving post-filing finance a special priority, although this is likely to have an effect on the cost of credit if the repayment of the new finance is given priority over existing secured creditors.

²⁴ Section 437A of the Corporations Act 2001.

²⁵ See New Zealand Law Commission. *Insolvency Law Reform: Promoting Trust and Confidence*.

Question for Submissions

14. Do you consider that there are any good reasons to depart from the Australian approach to post-filing finance and use of existing company funds?

Creditor Voting on the Proposal

114. The assumption in this paper is that a business rehabilitation regime provides a “breathing space” to allow a proposal to be formulated and then presented to creditors for their approval. Creditors would be required to approve the rehabilitation proposal before it becomes binding.

115. In the Australian voluntary administration regime, the voting procedure at creditors’ meetings is set out in the Australian Corporations Regulations. The voting procedure used is the same as for company wind-ups under the Corporations Act 2001. Voting is generally decided on a majority of voices by declaration of the chairperson, unless a poll is required by the chairperson, by at least two creditors or by a creditor with more than 10% of the voting rights.²⁶ If a poll has been demanded, a resolution will be carried if:²⁷

- A majority of the creditors voting vote in favour; and
- The value of the debts owed by the corporation to those voting in favour of the resolution is more than half the total debts owed to all the creditors voting.

116. The resolution is not carried if:²⁸

- A majority of creditors voting vote against; and
- The value of the debts owed by the corporation is more than half the total debts owed to all creditors voting.

117. Where there is no clear outcome the chairperson has a casting vote.²⁹

118. The New Zealand Law Commission has recommended the requisite majorities currently used in Part XIV of the Companies Act 1993 (75% of creditors attending a creditors meeting) be retained in a new rehabilitation regime. The Law Commission has also suggested the requirements in the current legislation for voting by different

²⁶ Reg 5.6.19 Australian Corporations Regulations.

²⁷ Reg 5.6.21 Australian Corporations Regulations.

²⁸ *Ibid.*

²⁹ *Ibid.*

classes be removed.³⁰ Of relevance will be which creditors are bound by the procedure and therefore which creditors, if any, are excluded from voting.

119. A clear and simple voting procedure could attract a debtor to use the rehabilitation regime and encourage creditors to participate in the regime. In setting voting requirements, a balance needs to be found between the need to protect the collective interests of creditors and protecting those interests to such an extent that the regime will be unworkable.

120. The Australian voting provisions apply to all insolvency proceedings. These provisions differ from current New Zealand insolvency voting provisions. However, the existence of differing voting requirements in New Zealand and Australia would cause practical problems in the event of a trans-Tasman administration and could preclude the operation of any mutual recognition regime.

Question for Submissions

15. Do you consider that the advantages of adopting voting provisions similar to Australian provisions outweigh the potential costs, which could include inconsistency with other New Zealand insolvency provisions?

The Qualifying Criteria for Administrators

121. An issue that would need to be considered in the design of a new business rehabilitation regime is the possible introduction of criteria for the qualification of administrators.

122. The Australian regime requires the appointment of an independent administrator to undertake key duties following the initiation of the procedure. Under Division 14 of Part 5.3A of the Australian Corporations Act 2001 an administrator must:

- i. Consent to being appointed;
- ii. Be a registered liquidator; and
- iii. Not fall within a specified category of people that have a relationship with the company.

123. The individuals included under (iii) include:

- A person who is indebted to the company or related company by more than \$5,000;
- A creditor of the company or related company in an amount exceeding \$5,000;
- An officer of the company or a partner, employer or employee of an officer;

³⁰ See New Zealand Law Commission. *Insolvency Law Reform: Promoting Trust and Confidence*.

- An auditor of the company or partner or employee of an auditor; and
- An officer of a body corporate that is a mortgagee of property of the company.

124. Registration as a liquidator in Australia is governed by Part 9.2 of the Corporations Act 2001. Generally, the requirements include prescribed educational achievements and at least five years relevant experience. These requirements are set out more fully in Appendix II.

125. Currently New Zealand has no occupational regulation of liquidators. There may, however, be a greater case for adoption of occupational regulation for administrators, given that they would have a more active role in the management of a company. There are various options for addressing these concerns, such as legislative prohibitions on administrators who have relationship with the company and the ability for creditors to replace an administrator.

126. If New Zealand were to adopt qualifying criteria for administrators as part of a new business rehabilitation regime, then there may be benefits in adopting qualifying criteria similar to, or the same as, the Australian criteria outlined above. Under the Trans-Tasman Mutual Recognition Act 1997, adoption of these criteria would mean that New Zealand administrators would be eligible to undertake administrations in Australia and vice versa. This could increase the pool of available skilled and experienced administrators available in both countries. It should be noted, however, that New Zealand insolvency practitioners are currently entitled to gain an Australian registration, provided they meet the Australian criteria.

127. There are also potential costs with implementing an occupational regulation regime for administrators similar to that in Australia. These include the concern that it could present a barrier to entry into the profession which would limit competition and therefore increase administrator's fees. This would make the procedure more expensive and therefore less accessible for smaller businesses.

Questions for Submissions

16. Do you think that criteria similar to that in Australia for regulation of administrators would be required in New Zealand for the effective functioning of a business rehabilitation regime? In particular, can you identify any particular risks associated with having less regulated administrators involved in the management of a company under registration?
17. Do you think that the benefits identified of co-ordination with Australia in this area would outweigh the additional costs for New Zealand administrators and businesses wanting to use the procedure?

Summary of Questions

Questions for Submissions

1. Do you agree with this assessment of the problems with the current Companies Act provisions?
2. Can you identify any other problems with the current business rehabilitation regime not covered in this section?
3. Do you consider that the current regime favours liquidation over rehabilitation?
4. Keeping in mind the Government's economic development objectives, do you consider the benefits of favouring liquidation over rehabilitation outweigh the costs?
5. Do you have any evidence or view that affirms or rejects the assumption that under current New Zealand law creditors will have both the commercial judgement and incentives to support rehabilitation where it is most viable?
6. Do you believe that the interests of the business and creditors as a whole would be enhanced by introducing a more comprehensive business rehabilitation regime that includes a stay on secured creditors?
7. If New Zealand were to adopt a new business rehabilitation regime then should we co-ordinate with the Australian voluntary administration procedure? What further reasons for and against co-ordinating with the Australian approach can you think of?
8. Do you consider that the Australian safeguards of the interests of creditors are sufficient? Would you support the adoption of these safeguards in a New Zealand business rehabilitation procedure? Why or Why Not?
9. Do you favour appointment of an administrator by a business, creditor or both? What are your reasons?
10. Do you consider that the reduced costs associated with an automatic stay outweigh the benefits of court involvement in the process?
11. Can you identify any reasons for departing from the Australian approach in terms of the length of the stay?
12. Do you consider that there are any good reasons for departing from the Australian procedure on the failure of an administration, which allows flexibility for a company to swap between procedures at the end of the stay period?
13. Can you identify any reasons to depart from the Australian regime in respect of control of management? In particular, do you consider this regime creates the right balance between the continuing efficient operation of the business and the prevention of further losses to the company?
14. Do you consider that there are any good reasons to depart from the Australian

approach to post-filing finance and use of existing company funds?

15. Do you consider that the advantages of adopting voting provisions similar to Australian provisions outweigh the potential costs, which could include inconsistency with other New Zealand insolvency provisions?
16. Do you think that criteria similar to that in Australia for regulation of administrators would be required in New Zealand for the effective functioning of a business rehabilitation regime? In particular, can you identify any particular risks associated with having less regulated administrators involved in the management of a company under registration?
17. Do you think that the benefits identified of co-ordination with Australia in this area would outweigh the additional costs for New Zealand administrators and businesses wanting to use the procedure?

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Appendix I - The Australian Approach to Business Rehabilitation

The Australian voluntary administration procedure applies to any insolvent company registered under the Corporations Act 2001. The procedure was designed to encourage greater use of company re-organisation as opposed to winding-up. One of the reasons it had been suggested that companies were not using the previous re-organisation procedures was because they were seen as being expensive, inflexible and cumbersome. This made re-organisation inefficient, particularly for smaller companies. The current Australian procedure was designed with the aim that it would be:

- Capable of swift implementation;
- As uncomplicated and inexpensive as possible; and
- Flexible, providing alternative forms of dealing with the financial affairs of the company.³¹

The Australian voluntary administration regime has been in operation since mid 1993. Voluntary administration is initiated by appointment of an administrator in one of three ways:

- By a resolution of the board of a company (s 436A);
- By a chargee over all or substantially all of the property where the charge is enforceable (s 436C); or
- By a liquidator (s 436B).

Once appointed, the administrator has control of the company's business, property and affairs and acts as the company's agent (s 437B). During that period, its officers cannot exercise any function, except with the administrator's written approval (s 437D).

The administrator must notify a chargee whose charge relates to all or substantially all of the property of a company of their appointment. The chargee is then permitted to enforce the charge within 10 business days of the administrator's appointment (s 441A).

When a company is under administration, there is a stay on actions against the company and its property. This applies to:

- Secured creditors (with limited exceptions) (s 440B);

³¹ Australian Law Reform Commission. *General Insolvency Inquiry*. Report 45. (Sydney: Australian Law Reform Commission, 1988).

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- Owners or lessors of property possessed, used or occupied by the company with limited exceptions (s 440C); and
- Unsecured creditors (s 440D).

The stay prevents:

- The company from being wound up voluntarily (s 440A);
- Charges from being enforced (s 440B) (except charges over all or substantially all the property of a company that are enforced within the 10 day decision period (s 441A), charges where the enforcement action had begun before the administrator was appointed (s 441B), and charges over perishable property (s 441C);
- An owner or lessor from recovering property which is being used by the company (s 440C) (except where rights of repossession had already begun to be exercised (s 441F), or where the property is perishable (s 441G)); and
- Proceedings against the company and any enforcement action in relation to proceedings already taken (s 440D, 440F).

The administrator must hold a meeting of creditors within 5 days of appointment (s 436E). At this meeting the creditors decide whether to appoint a committee of creditors and also have the opportunity to replace the administrator with their own appointee (s 436E).

Within 21 days of the appointment of the administrator, the administrator must convene a meeting of creditors to decide the company's future (s 439A). With the notice of the meeting, the administrator must give the creditors a report about the company's business, property, affairs and financial circumstances. The administrator must also provide a statement setting out his or her opinion with reasons on whether it would be in the creditors' interests for (s 439A):

- The company to execute a deed of company arrangement;
- The administration to end; or
- The company to be wound up.

If a deed of company arrangement is proposed, the report must also include a statement setting out details of the proposed deed (s 439A).

If the creditors resolve to accept the deed, it must be executed by the company and the deed administrator (s 444B). The administration ends once the company becomes subject to the deed. Deeds are administered by the deed administrator or the company's directors (s 435C).

A deed is binding on:

- All unsecured creditors of the company (s 444D);

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- Secured creditors who have voted for the deed (s 444D);
- Owners or lessors of property possessed, used or occupied by the company who have voted for the deed (s 444D);
- The company (s 444G);
- The company's officers and members (s 444G); and
- The deed's administrator (s 444G).

The Court may also order that the deed is binding on secured creditors and owners or lessors of property who did not vote in favour of the deed. It can only do so when it is satisfied that for the creditor to realise or otherwise deal with the security would have a material adverse effect on achieving the purposes of the deed, and that the creditor's interests will be adequately protected (s 444D, 444F).

Appendix II - Australian Qualifications for Administrators

Under Part 9.2 of the Corporations Act 2001, ASIC (the Australian Securities and Investments Commission) must grant an application for registration if:

- i. The applicant is a member of:
 - The Institute of Chartered Accountants in Australia, the Australian Society of Certified Practising Accountants or any other prescribed body; or
 - They hold a degree, diploma or certificate from a prescribed university or other prescribed institution in Australia and have passed examinations in subjects that the institution certifies to ASIC to represent a course of study in accountancy of not less than 3 years duration and in commercial law (including company law) of not less than 2 years duration; or
 - Has other qualifications and experience that, in the opinion of ASIC, are equivalent to these; and
- ii. ASIC is satisfied as to the experience of the applicant in connection with the winding up of corporate bodies; and
- iii. ASIC is satisfied that the applicant is capable of performing the duties of a liquidator and is otherwise a fit and proper person to be registered as a liquidator.

ASIC Policy Statement 40 sets out the experience criteria applied by ASIC to satisfy itself as to the experience of the applicant in connection with the winding up of bodies corporate. In general, an applicant must:

- Have had at least five years in public practice;
- Have obtained a wide range of experience in external corporate administrations under the direction of an official liquidator for a continuous period of not less than three years, including windings up, receiverships, reconstructions and voluntary administrations; and
- Have supervised external corporate administrations on a full-time basis for at least two consecutive years during the five years immediately before the date of the application.