



## Significant reform of New Zealand's insolvency laws proposed

“Earlier this month, the Ministry of Economic Development released a draft Insolvency Law Reform Bill and a discussion document relating to that Bill.”

### Background

Earlier this month, the Ministry of Economic Development (**MED**) released a draft Insolvency Law Reform Bill (the **Bill**) and a discussion document relating to that Bill. These two documents are the result of a general review of insolvency law that began in 1999.

Most of the policy decisions surrounding the reform have already been made by the Government and have been publicised. The MED's intention in circulating the Bill is, therefore, not to re-open the policy debate. Rather, its intention is to get feedback on the detail of the proposed legislation. Also, while the Government's intention was not to fundamentally change New Zealand's insolvency law, the proposed legislation certainly goes beyond minor amendments.

### Two parts to the Bill

Very broadly, the Bill is in two parts. The first part is a complete re-write of the Insolvency Act 1967, which governs the bankruptcy of individuals. The second part makes a number of changes to the various insolvency regimes applicable to companies, as set out in the Companies Act 1993. It also introduces a new insolvency regime – voluntary administration.

This note deals solely with the new voluntary administration regime, on the basis that it is likely to be the aspect of the Bill of most interest to financial institutions that deal with New Zealand companies.

### Voluntary administration

#### Background

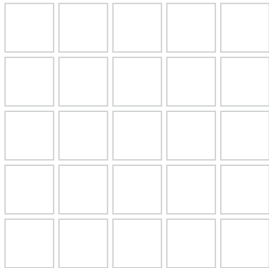
Currently, the only rehabilitative insolvency regime for viable companies is the compromise regime in Part XIV of the Companies Act. For a number of reasons (including, in particular, the need to obtain creditor consent), this has proved to be a difficult regime to apply in practice. The Government's view is that there should be an alternative regime that encourages business rehabilitation. In keeping with the continuing harmonisation of trans-Tasman business laws, the Government has settled on the voluntary administration model adopted by Australia in 1992.

The existing corporate insolvency regimes (compromises, liquidation, receivership and statutory management) will remain. No doubt, some will be disappointed by the retention of statutory management. Even though it has been used sparingly since its introduction 15 years ago, the fact that it exists on the statute books, and the fact that it is able to extinguish the most fundamental of creditor's rights, has made it (and, to a degree, New Zealand) unpopular with financial institutions.

#### Commencement of administration

The administration of a company begins when an administrator is appointed by:

- board resolution; or
- a liquidator; or
- a chargeholder having a charge over all,



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or substantially all, of the company's property where that charge has become enforceable; or

- the High Court, on the application of a creditor, a liquidator or the Registrar of Companies.

### Consequences of administration

The appointment of an administrator has three main consequences. First, it vests control of the company's business in the administrator. Secondly, it triggers obligations on the administrator to hold various creditors' meetings to try to seek a consensus on the future of the company. Thirdly, it imposes a stay on certain creditor actions (similar to the moratorium imposed in a statutory management). This third aspect is outlined further below.

While a company remains in administration, in the absence of administrator consent or a court order:

- a transaction or dealing that affects the company's property is void;
- a person may not enforce a charge over the company's property (subject to the exceptions referred to below);
- the owner or lessor of property occupied or used by the company may not repossess that property (unless repossession began prior to the commencement of the administration); and
- court proceedings against the company may not begin or continue.

Furthermore, in the absence of a court order, a person may not enforce a guarantee given in respect of the

company's liabilities by a director or their spouse or relative.

The general prohibition on the exercise of secured creditor rights does not apply to:

- a chargeholder having a charge over all, or substantially all, of the company's property who begins enforcing the charge no later than the 10th working day after the commencement of the administration; or
- any chargeholder who begins enforcing its charge prior to the commencement of the administration.

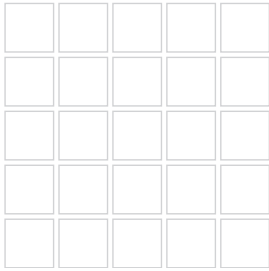
### End of administration

Administration is intended to be a relatively short-term measure that (by and large) freezes the company's financial position while the administrator and the creditors negotiate the company's future. The Bill prescribes a tight timetable for that negotiation process, which may be as short as 20 working days.

The administration of a company ends either when the negotiations have been successful (in which case, a "deed of company arrangement" is entered into) or when the statutory timeframe expires without resolution. Other steps, such as the appointment of a liquidator, can also end an administration.

### Significance for financial institutions

The Bill is only a draft at present. However, given the work and the consultation that has taken place over the last five years, there are unlikely to be many significant changes prior to the Bill's enactment. Based on the current



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form of the Bill, here are a few thoughts from a financial institution perspective.

- Financial institutions will need to check their standard form documentation to ensure that, if their borrower/counterparty is put into administration, an event of default arises. The need to assess *existing* documentation will, no doubt, be determined on a more selective basis.
- Financial institutions that typically take "all assets" security will need to ensure that their internal systems allow them to make enforcement decisions within the 10 working day "decision period". They should also ensure that they are notified of a company's administration as soon as possible after it begins.
- Financial institutions that typically take security over only certain assets of their borrower/counterparty will need to appreciate that they are at a relative disadvantage to "all assets" secured creditors. Given the stay on their

rights during administration, the Bill encourages enforcement action to be taken earlier than might otherwise be the case.

- Unsecured creditors will need to understand that the administration process may compromise their position in a number of respects. For example, if a company in administration borrows money, the liability for repayment of that debt has priority over the company's existing unsecured creditors. Also, if a deed of company arrangement is approved by the requisite creditors (a majority in number and value of those voting), it will bind *all* creditors.
- The administration regime does not, in contrast to the liquidation and statutory management regimes, expressly confirm the enforceability of netting agreements. This will be of concern not just to derivative counterparties but also to financiers who have set-off agreements in place with borrowers.

### Submissions

The MED has invited submissions on the Bill, to be received by **11 June 2004**. If you would like assistance in considering the significance of the Bill for your business, or in drafting submissions, please contact one of the Financial Services partners listed below.

For further information, please contact your usual Bell Gully adviser or:

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