Voluntary Administration in New Zealand – Impact on Secured Creditors

A paper delivered to the 24th Annual Banking and Financial Services Law & Practice Conference

Adelaide, South Australia

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August 2007

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W0001-019.0010

INTRODUCTION

In August 2000, the New Zealand Law Commission was asked by the Ministry of Economic Development, as part of its insolvency Law Review, to consider whether additional provisions should be inserted into New Zealand law to deal with business rehabilitation or reorganisation.

At the time, New Zealand Companies Legislation contained two formal insolvency procedures for compromising debts. They were:

Compromises with Creditors[1]

A straight forward procedure enabling the board of directors of a company, a receiver or liquidator or, with leave of the Court, any creditor or shareholder to propose a compromise between a company and its creditors. This procedure is easily initiated by giving notice of the intention to hold a meeting of creditors (or classes of creditors) to vote on a compromise and sending with that notice certain information relating to and the terms of the compromise. If the compromise is approved by 50% in number representing 75% in value of those creditors who voted, it is binding on all creditors who received notice (if class approval was required, it is presumed, unless the contrary was expressly stated in the resolution, that the approval of the compromise by each class is conditional on the approval of the compromise by every other class concerned).

The Court had power to give directions in relation to procedural requirements, or to waive or vary the requirements. The Court could also impose a moratorium from the date on which notice of the proposed compromise was given to not later than 10 working days after the date on which notice was given of the result of the vote. During the moratorium, proceedings against the Company are stayed and creditors cannot take any measure to enforce payment of debts owing by the Company. However, secured creditors are not affected by the moratorium. Generally speaking, lack of the ability to stay the actions of secured creditors did not result in frustration

[1]Part XIV of the Companies Act 1993

of the compromise process provided the compromise did not prejudice the secured creditor's interest and the creditor had confidence in the person administering the compromise (often an insolvency practitioner).

The Court also has powers to order that a creditor is not bound by the compromise, or make any other order about the compromise, if it is satisfied that there was some material irregularity in obtaining approval of the compromise or, in the case of a creditor who voted against the compromise, the compromise was unfairly prejudicial to that creditor or to the relevant class of creditors.

Approval of Arrangements and Compromises by the Court[2]

The Court, on the application of a Company or any shareholder or creditor, can order that an arrangement or amalgamation or compromise shall be binding on the Company and such other persons or classes of persons as the Court may specify. Before making the order the Court may order that notice of the application and information relating to it be given to certain specified persons or may order that meetings of creditors or any class of creditors be held to consider and approve the arrangements.

The Court has very wide ranging discretion. It can approve a compromise even though the compromise could be approved under the compromise procedure set out in Part XIV of the Act.

The Court's powers and the relevant procedures are very similar to the old Scheme of Arrangement procedures contained in earlier versions of both the New Zealand Companies and Australian Corporations Legislation. This process has some profile in New Zealand at the moment as it is occasionally being used to effect mergers and acquisitions - bypassing the more stringent provisions of the New Zealand Takeovers Codes.

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[2]Part XV of the Companies Act 1993

The Law Commission concluded[3] that having regard to the large number of small to medium enterprises which carry on business in New Zealand, there would be little or no benefit to creditors as a whole in introducing a widely drawn voluntary administration regime as it was likely that the costs involved in implementing the regime would be prohibitive. However, the Commission recommended that an additional rehabilitation regime be developed, targeted at larger businesses although the regime could also be used by small to medium sized businesses. That regime would permit existing management of the business to remain in control, with insolvency practitioners tasked to investigate and report on whether the business could be salvaged, to negotiate with creditors and management, to protect and secure the assets of the business and to oversee continued management with a power of veto. However, ultimately the Government chose to adopt a model very similar to the Australian voluntary administration regime.

New Zealand Voluntary Administration Regime

The regime was enacted in November 2006 and forms part of the New Zealand Companies Act 1993. However, it has not yet come into force. Last month the New Zealand Cabinet approved the drafting of the regulations needed before the legislation can come into effect. The Ministry of Economic Development anticipates that the legislation will come into effect in October – November 2007.

The regime is largely the same as the Australian voluntary administration regime. However, New Zealand has taken the opportunity to incorporate in the legislation most of the recommendations for the reform of the Australian law made by the Companies and Securities Advisory Committee in its June 1998 report on Corporate Voluntary Administration.

The regulations yet to be drafted are expected to follow closely those contained in the Australian Corporations Regulations 2001 – except in relation to some meeting procedures which will follow the existing New Zealand law for the conduct of creditors meetings in liquidations and compromises.

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[3]Study Paper 11 *Insolvency Law Reform – Promoting Trust and Confidence* An Advisory Report to the Ministry of Economic Development May 2001 Paragraphs 182-256

The voluntary administration regime is in addition to the two formal insolvency procedures referred to in the Introduction, which are unchanged. It remains to be seen whether the new regime will be used by small and medium sized enterprises in preference to the more straightforward creditors compromise under Part XIV of the Companies Act 1993. Unlike the situation in Australia, there is little incentive for directors of insolvent or near insolvent companies to use the new regime except to avoid (further) personal liability for insolvent or reckless trading. Directors do not have the same exposure to liability for unpaid company income tax, GST and PAYE as Australian directors do. In New Zealand the Inland Revenue Department still has preferential status for unpaid GST and PAYE in a receivership or liquidation and in practical terms will generally wish to retain that status under a Deed of Company Arrangement- in many situations this may adversely affect the administrator's ability to propose an arrangement (similar issues arise under Part XIV of the Companies Act 1993).

There are other factors which may impact on the use of the voluntary administration regime or the effectiveness of a particular administration. They include:

1. The majority needed to approve a Deed of Company Arrangement is 50% of creditors by number representing 75% of creditors by value who vote on the resolution. This is the same threshold as applies to creditors compromises under Part XIV of the Companies Act 1993. Some consider the threshold will often be too difficult to achieve. Until the regulations are promulgated, it is not clear what the extent of the administrator's casting vote will be. The exercise of casting votes has often been the subject of litigation in Australia.

2. Insolvency Practitioners are not regulated in New Zealand (see the discussion later in this paper).

3. There are potential difficulties with tax consequences of debt remission under both the voluntary administration regime and the creditors compromise provisions as in certain circumstances written off debt is assessable for income

tax. Also, depending on the terms of the Deed of Company Arrangement, the Company may be unable to take advantage of its tax losses.

Impact of Voluntary Administration on Secured Creditors

The Legislation

A person who holds a charge over the whole, or substantially the whole, of a Company's property is able to appoint an administrator if the charge has become enforceable – unless the Company is already in liquidation[4]. Other secured creditors may apply to the Court for the appointment of an administrator – the Court can appoint an administrator if it is satisfied that the Company is, or may become, insolvent and that an administration is likely to result in a better return for the Company's creditors than would result from an immediate liquidation of the Company, or if it considers it is just and equitable to do so[5]. This provision reflects a recommendation of the Company and Securities Advisory Committee.

The appointment of an administrator to a Company in receivership does not remove the receiver from office[6].

The administrator must hold the first creditors meeting to decide whether to appoint a creditors' committee and whether to replace the administrator (including an administrator appointed by a secured creditor) within eight working days of the date on which the administration began[7]. The administrator must convene the watershed meeting to decide the future of the Company within 20 working days after the date on which the administration began – the Court can extend the convening period on the administrator's application made before or after the period has expired. The watershed meeting must be held within five working days after the end of the convening period (or extended period)[8]. The watershed meeting may be adjourned

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[4] S.239K of the Companies Act 1993
[5] S.239L of the Companies Act 1993
[6] S.239AD of the Companies Act 1993
[7] S.239AN of the Companies Act 1993
[8] S.239AT & S.239AV of the Companies Act 1993

for up to thirty working days (or longer if the Court orders on the administrator's application)[9]. At that meeting the creditors may resolve that the Company execute a Deed of Company Arrangement, that the administration should end or (unless the Company is already in liquidation) that a liquidator be appointed[10].

If at the watershed meeting the creditors resolve that the Company execute a Deed of Company Arrangement but the proposed Deed is not fully approved, the administrator must draft a complete Deed and circulate it to creditors for comment after which the Company and the administrator must execute the Deed – all within strict time limits which can be extended for a short period by the Court[11].

A Deed of Company Arrangement binds a Company's creditors in respect of claims arising before administration which are specified in the Deed. However, secured creditors are not prevented from enforcing or otherwise dealing with their charge, except insofar as:

- the Deed provides otherwise in relation to a secured creditor who voted in favour of the resolution as a result of which the Company executed the Deed; or
- the Court orders otherwise[12].

The Court can make an order only if:

- it is satisfied that achieving the purposes of the Deed would be materially adversely affected if the order was not made; and
- having regard to the terms of the Deed and the order, and any other relevant matter, it is satisfied that the interests of the person affected by the order will be adequately protected[13].

Except as set out below, during the administration of the Company, a person cannot enforce a charge over the property of the Company without the administrator's written consent or the permission of the Court[14].

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[9] S.239AZ of the Companies Act 1993
[10] S.239ABA of the Companies Act 1993
[11] S.239ABB & S.239ACP of the Companies Act 1993
[12] S.239ACT of the Companies Act 1993
[13] S.239ACV of the Companies Act 1993

If before the beginning of the administration, a secured creditor has begun enforcing the charge, that enforcement process can continue[15]. If perishable property is subject to a charge then the charge over that property can be enforced during administration[16]. A person can give notice under the provisions of a security agreement at any time[17]. However, on the application by an administrator, the Court can order the secured creditor (or any receiver, or any other person) not to take certain enforcement steps – but only if it is satisfied that what the administrator proposes to do during the administration will adequately protect the secured creditor's interest. An order only has effect during the administration[18]. Similar provisions apply to owners or lessors of property in the possession of the Company[19].

The administrator is obliged to give notice of their appointment to, among others, a secured creditor who holds a charge over, or charges which together cover, the whole or substantially the whole of the Company's property, by no later than the end of the working day after their appointment[20]. That secured creditor is entitled to enforce the charge or charges in relation to all property of the Company subject to the charge or charges during a period of 10 working days after the day on which the notice is given (the decision period) or before that period begins[21]. Enforcement includes the appointment of the receiver. The receivership will run concurrently with the administration and, depending on its terms, any Deed of Company Arrangement. The Court does not have power to restrict that creditor's enforcement rights or actions during the administration period[22].

The administrator is entitled to charge reasonable remuneration - also the Court may on the application of a director, creditor or shareholder fix the administrator's remuneration at a level that is reasonable in the circumstances[23]. The administrator's right of indemnity out of the property of the Company for personal liabilities incurred

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[14] S.239ABC of the Companies Act 1993
[15] S.239ABM of the Companies Act 1993
[16] S.239ABN of the Companies Act 1993
[17] S.239ABP of the Companies Act 1993
[18] S.239ABO of the Companies Act 1993
[19] SS.239ABQ -ABT of the Companies Act 1993
[20] S.239ADW of the Companies Act 1993
[21] SS.239ABK-ABL of the Companies Act 1993
[22] S.239ABO(1)(b) of the Companies Act 1993 – but see S.239ACV where a Deed of Company Arrangement is entered into
[23] S.239O of the Companies Act 1993

by them in the performance of their duties and for their remuneration has priority over all the Company's unsecured debts and all debts of the Company secured by a charge over the accounts receivable and inventory of the Company other than where the security interest concerned is a purchase money security interest perfected within time under the Personal Properties Securities Act 1999 or a security interest arising from the transfer of an account receivable for which new value was provided by the transferee for the acquisition of that account receivable[24]. This provision in effect gives the administrator's remuneration the same priority ranking as unpaid wages and holiday pay of employees and unpaid GST and PAYE in a receivership or liquidation.

During the administration of a Company, a guarantee of a liability of the Company cannot be enforced against a director of a Company or that person's spouse or relatives – except with the consent of the Court[25]. However the release of the Company from a debt under a Deed of Company Arrangement does not discharge or otherwise affect the liability of a guarantor of the debt or a person who has given a creditor an indemnity in relation to the debt[26].

An administrator has wide powers to obtain documents and records of the Company, and information about the Company, including from any receiver[27]. These provisions give administrators more extensive powers than liquidators, as it would appear that (unlike liquidators) administrators have greater rights than receivers do to those records.

Observations

Because of the substantial similarities between the Australian and New Zealand regimes, practitioners and, in many instances, the Courts will look to Australian jurisprudence and practice to assist in interpreting and implementing the New Zealand voluntary administration provisions. For example, it is probable that New Zealand Courts are likely to adopt the principles applied by the Australian Courts in deciding whether a secured creditor (or its receiver) should be restricted in exercising

[24] S.239ADM of the Companies Act 1993
[25] S.239ABJ of the Companies Act 1993
[26] S.239ACW of the Companies Act 1993
[27] S.239AG of the Companies Act 1993

enforcement rights otherwise available to them during the administration period or whilst a Deed of Company Arrangement is in force.

As to decisions which secured creditors might make when faced with an administration, particularly those creditors with a charge over all or most of a Company's property, the practice and approach is again likely to be similar to that of Australian secured creditors under the Australian regime. The options are to:

- appoint an administrator
- permit an administration initiated by others to proceed and to participate in the restructure
- appoint a receiver
- enforce its security under the Personal Properties Securities Act.

Banks and other major financial institutions are generally reluctant to appoint receivers, except as a last resort. There will be a number of situations where the secured creditor will permit the administration to proceed rather than appoint its own receiver or enforce its security in other ways. These will include where:

- the creditor has confidence in the ability of the administrator and perceives its security position could be enhanced or certainly not prejudiced;
- the Company is one of a number of companies in a group under administration and there is a likelihood that the asset value of the companies in which the secured creditor is interested could be maximized under a group administration;
- the administrator has greater control in respect of property of the Company over which other creditors have prior ranking security interests (e.g. specific security interest over an essential item of plant or significant retention of title claims) and over property leases;
- the secured assets may have risks associated with them (e.g. contaminated land) which a secured creditor does not want to take on.

Further, a receiver will often require an indemnity (although Banks and major financial institutions generally limit the indemnity to invalid appointment or unenforceability of the security interest). A secured creditor does not need to provide an indemnity to an administrator.

Unlike in Australia, insolvency practitioners are not regulated in New Zealand. Currently, virtually anyone over the age of 18 years who is not of unsound mind, is not prohibited from being a director or receiver or liquidator, is not a creditor of the Company and has not been a shareholder, director, auditor or receiver of the Company or of a related company in the past two years can be appointed as an administrator. However, it is likely that in most circumstances where the Company has a secured creditor with a charge over all its assets and undertaking, there will be some communication between the Company and the secured creditor before an administrator is appointed. In many instances, the secured creditor is likely to have an input into that appointment if it is perceived that its interests may be better served than appointing a receiver.

It is also likely that secured creditors with the ability to appoint a receiver during the 10 working day decision period following the appointment of an administrator may adopt the Australian practice of negotiating a Deed of Forbearance with the administrator. Under that Deed the secured creditor agrees not to appoint a receiver during the decision period on the basis that the administrator agrees to consent to the appointment of a receiver after that period if the secured creditor gives notice requiring that consent. In this way the creditor retains the ability to appoint a receiver but until then obtains all the benefits of the administration. Also, a Deed of Company Arrangement resulting from the administration may prove more beneficial to the secured creditor than realization of the secured assets by a receiver.

If a Deed of Forbearance has been executed, the administrator has the benefit of being able to perform their duties without the difficulties and conflicts created by the appointment of a receiver.

As the writer understands it, the validity of Deeds of Forbearance has yet to be tested. There is an argument to the effect that the administrator is given a statutory discretion to allow the enforcement of a charge outside the decision period - by agreeing in advance to an appointment outside that period if the secured creditor requires, the administrator is improperly fettering their discretion as it should be exercised in light of all the circumstances at the time the administrator is called upon to exercise it.

Further, the Deed of Forbearance is a device effectively extending the decision period prescribed by statute. The contrary argument is that the effect of a Deed is consistent with the objectives of a voluntary administration regime – to endeavour to achieve an outcome beneficial to all creditors of the Company. Terry Taylor of Ferrier Hodgson put it this way in a letter to the editor of the Australian Insolvency Law Journal (one of a number of letters received on this issue)[28]: *As a general rule administration with the secured creditors "permission" is likely to be of greater benefit to unsecured creditors, than simple enforcement of a charge by the secured creditor for its benefit.*

In light of the administrator's power to subsequently finalise the drafting of a Deed of Company Arrangement which is not fully approved at the watershed creditors' meeting, [29]the Deed of Forbearance should also include a covenant by the administrator not to include in the final version of the Deed of Company Arrangement any provisions which may adversely impact on the secured creditors security position – except to the extent expressly approved by the creditor.

A similar type of arrangement could be entered into between a secured creditor, its receiver and the administrator where a receiver has been appointed prior to the commencement of the administration. If the secured creditor saw no benefits or disadvantage to it, an agreement could be reached that the receiver's powers were preserved but the administrator was permitted to deal with the secured assets on certain terms as part of the administration process.

For those secured creditors who do not hold security over the whole or substantially the whole of the Company's assets and undertaking, the voluntary administration regime may well encourage enforcement action to be taken earlier than might otherwise have occurred – because of the inability of those creditors to enforce their security during the administration. Those creditors may not be prepared to rely on obtaining the administrator's consent to enforce, or to pursue the not inexpensive option of attempting to obtain the permission of the Court.

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[28] Australian Insolvency Law Journal (1998) 10 (3) and (4)
[29] S.239ACP of the Companies Act 1993

Required Changes to Secured Creditor Processes and Documentation

Process

Secured creditors who take security over "all present and after acquired property" of a Company will need to ensure that they are able to make decisions within the 10 working day decision period whether to enforce their security. Internal control procedures will need to be reviewed to ensure that any notice of appointment of administrator received by the creditor will be promptly directed to the person or department who will have the responsibility of making those decisions.

Secured creditors who do not typically take security over "all present and after acquired property" of a Company will need to consider whether to seek more extensive security. Those creditors will include creditors holding charges over specific assets and those holding purchase money security interests (including retention of title creditors and lessors under leases for a term of more than one year). We may see those creditors including in their terms of trade provisions where the debtor creates a security interest in not only the goods being supplied or the specific asset being financed, but also in all its present and after acquired property. The required changes to the terms of trade would not be significant. Although creation by a debtor of that type of security interest will invariably constitute an event of default under security agreements previously issued to a debtor's financiers, many debtors would not have considered that point and the default may not become apparent to the debtor's financiers until the Company is placed in voluntary administration or the creditor concerned has taken enforcement action. It is unlikely that such a practice will become commonplace in the foreseeable future as all but the most sophisticated trade creditors do not have an in-depth understanding of the New Zealand Personal Properties Securities regime or insolvency and restructuring law. However, interesting practical issues may arise, or recourse to the Courts during the administration may be necessary, if terms of trade include provisions enabling a trade creditor or owner or lessor of property to fall within the category of secured creditor which is able to enforce its charge during the decision period.

Documentation

The Ministry of Economic Development signaled the Government's intention to introduce a voluntary administration regime very similar to the Australian regime in April 2004, when it released a discussion document which contained a draft bill setting out the proposed new regime. As a result, secured creditors have had considerable time to change their loan and security the documentation to accommodate the impact of the new regime. For those who have not already reviewed their documentation, the key changes will be the inclusion of provisions to the following effect (to the extent that they are not already included).

1. A covenant that the debtor may not without the consent of the secured creditor appoint an administrator. Knowledge of an imminent administration will in theory give the creditor the ability to enforce its charge before administration or, where applicable, provide an opportunity for the creditor to negotiate a Deed of Forbearance.

2. Events of Default will be extended to include the appointment of an administrator and the entering into of a Deed of Company Arrangement (this may also cover similar events happening to a related body corporate or a guarantor). There are numerous variations of wording which have been used including *any formal or informal kind of insolvency administration* or the debtor proposing or being the subject of *any reorganization, moratorium or other administration involving its creditors or any class of its creditors.*

3. The ability to appoint a receiver in relation to any secured property which appears to the secured creditor to be in jeopardy or in danger of seizure.

4. A catch all Event of Default - *if anything analogous to or having a similar effect to any other Events arises under the law of New Zealand or of any place outside New Zealand.*

5. A provision that the security interest is not discharged nor the debtor's obligations affected by the administration of the Company.

6. A covenant not to or allow to occur anything that might render the security interest unenforceable or otherwise adversely affect the security interest.

7. A provision to the effect that if the security agreement conflicts with, varies or is contrary to the provisions of any law, to the extent that the provisions of or implied by that law cannot be varied or negated, the provisions of the security agreement must be read subject to them.

Some provisions appearing in Australian security documents will not be reflected in New Zealand documents because the distinction between fixed and floating charges has been made redundant under the Personal Properties Securities Act 1998 – a security interest attaches pursuant to Section 40 of that Act and not pursuant to some subsequent crystallizing event, or in the case of certain after-acquired consumer goods as a result of specific appropriation by the debtor (Section 44).

Conclusion

The objects of a voluntary administration regime are to provide for the business, property and affairs of an insolvent or near insolvent company to be administered in a way that:

1. maximizes the chances of the Company, or as much as possible of its business, continuing in existence;
2. if that is not possible, results in a better return for the Company's creditors and shareholders than would result from the immediate liquidation of the Company[30].

In the author's view, the provisions of the regime strike the right balance between giving effect to those objects and giving due regard to the rights of secured creditors. However, the position could be improved if insolvency practitioners were regulated – experienced and reputable practitioners are more likely to have amuch better understanding of the extent to which the rights of secured creditors should be fettered during administration and the circumstances in which consent should be given to

[30] S.239A of the Companies Act 1993

creditors to enforce their security interests when they otherwise would not be able to. The regime also permits receiverships and administrations to run concurrently.