WORK-OUTS
STATUTORY MANAGEMENT IN NEW ZEALAND

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INTRODUCTION

Those of us involved in the banking industry in New Zealand have had to develop thick skins and a sense of humour in dealing with our overseas colleagues since the October 1987 share crash. You may or may not know that the Maori name for New Zealand is Aotearoa, which means in English "The Land of the Long White Cloud". Following the October 1987 crash, some overseas commentators were asking whether the English interpretation of Aotearoa should instead read "The Land of the Long Put Option" following the emergence of many unknown contingent liabilities in the balance sheets of some of our more spectacular corporate collapses.

Statutory management in New Zealand has now superseded the previous references to undisclosed put and call option as being one of the topics one invariably discusses with our Australian colleagues during trans-Tasman telephone calls. The topic is usually introduced by one's Australian colleague asking the question, "What is happening in New Zealand regarding statutory management, and is it true that my Australian banking client cannot immediately enforce its security which it holds in New Zealand against one of the New Zealand companies which has been placed in statutory management?" There is usually silence, a gulp and then some colourful language when you respond with the answer "Yes".

As John King has already mentioned, and as my synopsis indicates, I will be referring to the appointment of statutory managers to DFC New Zealand Limited, hereinafter referred to as DFC, and in particular, I will deal with the *Reserve Bank of New Zealand Act* 1989, which I shall refer to as the *Reserve Bank Act*, which is the legislation under which the present statutory manager of DFC operates.

Before dealing with that topic, it is, however, important to stress that not every corporate collapse in New Zealand is handled by the immediate appointment of statutory managers. The facts are that only four New Zealand groups of companies have had

statutory managers appointed to them in recent times, those groups of companies being, Equiticorp, Richmond Smart, Chase property group and DFC.

John King has already explained to you the background to the *Corporations (Investigation and Management) Act* 1989 and its application to Equiticorp, Richmond Smart and the Property Division of Chase.

On 3 October 1989, DFC was declared by Order in Council pursuant to the provisions of the *Reserve Bank of New Zealand Act* 1964, to be subject to statutory management. For those of you who are unfamiliar with DFC, some facts and information. DFC was originally owned by the New Zealand Government and was set up with one of its objects being to provide development finance to assist them in their development. Whilst DFC was not a registered bank in New Zealand, it was, however, at the cutting edge of international fund-raising techniques for New Zealand banks and financial institutions. At the time of its collapse, it reputedly had borrowings of some $1.21 billion New Zealand dollars from Japanese banks on an unsecured basis and it was reported that, at the time of its collapse, it held one of New Zealand's largest swap books with an estimated total value of approximately $33 billion New Zealand dollars.

Some of you will be aware, especially those of you who have acted for DFC in Australia, that some of the funding DFC obtained was lent to Australian corporates such as the Qintex group.

OUTLINE OF THE PROVISIONS OF THE RESERVE BANK OF NEW ZEALAND ACT 1989

The *Reserve Bank Act* deals with the constitution, functions and powers of the New Zealand Reserve Bank, which is New Zealand's central banker.

Under s 68 of the *Reserve Bank Act*, the powers conferred by Part V of the Act on the Reserve Bank are to be exercised for the purposes of promoting the maintenance of a sound and efficient financial system, or avoiding significant damage to the financial system that could result from the failure of a registered bank.

Section 117 of the *Reserve Bank Act*, empowers the Governor-General, by Order in Council on the advice of the Minister of Finance given in accordance with the recommendation of the Reserve Bank, to declare any registered bank to be subject to statutory management and to appoint one or more persons as statutory manager or statutory managers of that registered bank. As I indicated earlier, the initial appointment of statutory managers to DFC was made under the *Reserve Bank of New Zealand Act* 1964, which contained similar provisions to those which I have just referred to which appear in the *Reserve Bank Act*, with the important exception that the 1964 Act allowed the appointment of statutory managers to financial institutions such as DFC, which were not registered banks. The provisions of the *Reserve*

Bank Act apply only to registered banks but, by virtue of s 189 of the *Reserve Bank Act*, it was possible for the Governor-General by Order in Council on the advice of the Minister of Finance given in accordance with a recommendation of the Reserve Bank, to declare that any person that was subject to statutory management under the *Reserve Bank of New Zealand Act* 1964 shall become subject to statutory management under the *Reserve Bank Act*. This occurred in the case of DFC.

The 1964 *Reserve Bank Act* provided that the Reserve Bank was not to make a recommendation that a specified institution, which included DFC, be subject to statutory management unless it was satisfied on reasonable grounds that, amongst other things, the specified institution was insolvent or was likely to become insolvent or that the specified institution had suspended or was about to suspend payment or was unable to meet its obligations as they fell due.

John King has elaborated on the procedure for appointing statutory managers under the *Corporations (Investigation and Management) Act* 1989 and as you will note from my comments, there is a distinction to be drawn in the case of DFC where statutory managers were appointed to DFC under different legislation, namely the *Reserve Bank of New Zealand Act* 1964 and that the recommendation for the appointment of statutory managers was made by the Reserve Bank to the Minister of Finance, whereas under the *Corporations (Investigation and Management) Act* 1989 the appointment of statutory managers is made on the recommendation of the Securities Commission to the Minister of Justice.

As I mentioned earlier, DFC was a major participant in the New Zealand swap market - apart from its other merchant banking activities. DFC came within the provisions of the 1964 *Reserve Bank Act* and the appointment of statutory managers to DFC presumably was made on the basis that if DFC defaulted in its obligations to banks and financial institutions without some system of control in place, severe disruptions may have occurred in the New Zealand financial system, particularly in regard to inter-bank/financial institution settlements.

I, along with a number of other New Zealand banking lawyers, am opposed in principle to the New Zealand approach of statutory management, particularly where the effect is to suspend or interfere with the rights of secured creditors, on the philosophical basis that such interference infringes the fundamental principle of contract law, namely the sanctity of contract. I know this audience needs no reminding of the importance of the principle of sanctity of contract in banker and borrower contractual relationships.

DFC however, in view of its position in the New Zealand financial system and the repercussions that may have flowed if it had been allowed to default under its obligations to banks and financial institutions without some system of central bank control in

place, may have justified the use of statutory management as an exception to the principle of sanctity of contract.

As a personal view, one wonders however what approach say the Bank of England may have taken if DFC had been an English bank; one suspects a less dramatic approach with the so-called "Life Boat technique" being adopted whereby the Bank of England would have organised other banks to assist in supporting the defaulting bank.

My reason for posing that question, and I would welcome Philip Wood's response, is that in the case of DFC one of its major group of creditors, the unsecured Japanese banks, appear not to have been consulted before the appointment of statutory managers to DFC. The shocked reaction of some of the Japanese banks to DFC's demise could be summed up in the failure by Nomura Securities Ltd and the New Zealand Treasury to float a major bond issue in Japan shortly after the collapse of DFC.

The moratorium provisions contained in the *Reserve Bank Act* which now apply to DFC are similar to the moratorium provisions which John King has alluded to under the *Corporations (Investigation and Management) Act* 1989. As John has mentioned, they are far reaching, although in the case of DFC, there are few creditors, if any, who had any formal security over the assets of DFC, the rights under which are suspended whilst DFC is subject to statutory management.

It is of particular interest to bankers that whilst DFC is subject to statutory management, no person is entitled to exercise any right of set-off against DFC. This raises the interesting jurisdictional question, where a bank situated in, say, Australia, is owed money by DFC and has cash deposits of DFC deposited with the bank in Australia as to whether the Australian bank would refrain from exercising its rights of set-off. I suspect that the banker's traditional approach that "possession is nine-tenths of the law" would determine the outcome of that question.

The New Zealand experience of statutory management, particularly under the *Corporations (Investigation and Management) Act* 1989, has not been a pleasant experience for either bankers with New Zealand exposures or New Zealand corporates who borrow off-shore. Some brief comments on the implications that have flowed from the use of statutory management in New Zealand:

(i) firstly, we know from our personal experience that some New Zealand corporates who have regularly borrowed on the international money markets have either had difficulty in raising money off-shore, particularly from Japanese banks, or if they have been successful in borrowing money off-shore they have had to pay a higher interest margin for those funds than was previously the case, because of the uncertainty that statutory management has introduced.

Greater uncertainty or risk in lending transactions, as we all know, requires a higher rate of return to the lenders concerned;

(ii) secondly, as some of you will be aware, opinions from the larger New Zealand law firms in relation to off-shore loan transactions involving New Zealand borrowers now contain a specific qualification relating to statutory management in New Zealand;

(iii) thirdly, fertile legal minds have considered techniques to protect lenders from the consequences of statutory management in New Zealand and the resulting suspension of their creditor rights. Some of those techniques include taking security outside New Zealand from overseas subsidiaries of New Zealand borrowers and trying to establish contractual rights of set-off which are triggered automatically just prior to the appointment of a statutory manager; and lastly

(iv) an indirect but important implication, given the stated objective of harmonisation of business law between Australia and New Zealand, is the question of where does the statutory manager fit in the jigsaw puzzle of harmonisation of business law between the two countries.

As to the future of statutory management in New Zealand, it is encouraging to report that the New Zealand Securities Commission has been prepared to talk to interested parties regarding the impact of statutory management in New Zealand and possible law reforms. My personal suggestion is that the *Corporations (Investigation and Management) Act* 1989 should be repealed tomorrow. Given that such drastic law reform is unlikely to be accepted, some suggested reforms would include:

(i) requiring that more consultation take place with a wider range of interested parties before statutory management is allowed to occur, ie. no more weekend appointments;

(ii) allowing more active and independent review by the courts of statutory managers' actions to protect the interest of secured creditors; and

(iii) providing for a set period of appointment of statutory managers with the appointment not being renewed unless satisfactory progress is being made in rationalising the affairs of the company which is in statutory management.

Finally, when one considers New Zealand's position in the heady days of the mid-1980s with Mr Judge and Mr Hawkins in full flight when compared with the post share market crash era of corporate collapse and statutory management, one is reminded of a quote which goes like this: "Some days you're the pigeon; some days you're the statue."

Given the proposal for insolvency law reform in Australia contained in the Harmer Report with its impact on the rights of secured creditors, and the brief which I understand the proposed Australian Securities Commission is to have to investigate the causes of corporate collapse in Australia, my comment to the representatives of the Australian banking industry who are present at this conference, and to their advisers, is that in Australia you must be very careful to hold the line against statutory law reform which seriously impinges upon the principle of sanctity of contract between banker and borrower, or otherwise you, too, may become a statue, or at least, have your wings clipped.