WORK-OUTS
STATUTORY MANAGEMENT IN NEW ZEALAND

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I. INTRODUCTION

In New Zealand a company in financial difficulties has to consider the following possibilities:

(i) Compromises with creditors including schemes of arrangement under s 205 of the *Companies Act* 1955;

(ii) Receivership pursuant to a debenture or other similar contractual arrangement;

(iii) Winding up under Part VI of the *Companies Act* 1955;

(iv) Application of the provisions of the *Corporations (Investigation and Management) Act* 1989 including the appointment of a statutory manager.

This paper considers the statutory management regime under the *Corporations (Investigation and Management) Act* 1989, which is of some significance to lenders to New Zealand companies and has been the subject of much comment and criticism over recent months.

II. CORPORATIONS (INVESTIGATION AND MANAGEMENT) ACT 1989

(1) BACKGROUND TO THE ACT

The *Corporations (Investigation and Management) Act* 1989 came into force on 22 March 1989. The Act grew out of earlier legislation.

Back in 1934 the New Zealand Parliament enacted the *Companies (Special Investigations) Act* 1934 as a result of public concern with the fund raising activities of an Auckland financier J.W.S. McArthur. That Act initially granted to a commission special powers of investigation of McArthur's group of companies and by a subsequent amendment appointed the Public Trustee as receiver and manager of the group.

Similar concerns with another group of companies in 1958 led to the enactment of the *Companies Special Investigations Act* 1958. Against a background of suspected fraud this Act appointed receivers and managers of the group of companies concerned with extensive powers. In 1963 the Act was amended so that it could be applied to other companies by Order in Council, whereas previously this could only have been achieved by amending the Act itself.

In 1989 the *Corporations (Investigation and Management) Act* ("the Act") replaced the 1958 Act following application of that Act to the Equiticorp group of companies and the Richmond Smart group of companies. The new Act considerably expanded the scope of the previous Act.

(2) CONTENT OF THE ACT

(a) **Application**

The Act applies to any corporation:

(i) that is, or may be, operating fraudulently or recklessly; or

(ii) to which it is desirable that the Act should apply for the purpose of preserving the interests of the corporation's members or creditors, or protecting any beneficiary under any trust, or for any other reason in the public interest, if such interests cannot be adequately protected under existing law.

By contrast to the 1958 Act, the new Act is not limited to companies but extends to corporations whether incorporated or not, irrespective of the country of incorporation, and also to persons associated with the corporation.

(b) **Objects**

The general objects of the Act are:

(i) To confer powers on the Registrar of Companies to obtain information concerning, and to investigate the affairs of, corporations to which the Act applies.

(ii) In the case of a corporation that is, or may be, operating fraudulently or recklessly, to limit or prevent:

    (a) the risk of further deterioration of the financial affairs of that corporation; and

    (b) the carrying out, or the effects of, any fraudulent act or activity.

(iii) In the case of a corporation to which it is desirable in terms of the Act that the Act should apply, to preserve the interests of members, creditors, beneficiaries or the general public.

(iv) To provide for the corporation's affairs to be dealt with in a more orderly and expeditious way.

The Act requires that the Governor-General, the Minister of Justice, the Securities Commission and the Registrar shall exercise the powers conferred upon them by the Act in accordance with the above general objects.

(c) **Format**

The Act is divided into three main parts.

(i) **Part I - Disclosure of Information and Investigations**

Part I confers on the Registrar of Companies wide powers to require financial information from corporations and associated persons. It places an obligation on statutory supervisors and trustees for the holders of securities (as defined by the *Securities Act* 1978) to disclose to the Registrar financial information if they consider the corporation concerned faces, or is likely to face, serious financial difficulties. It also requires the auditors of a corporation to disclose information if requested by the Registrar to do so. The Registrar also has power to appoint any person to investigate the affairs of a corporation for the purpose of determining whether to exercise the powers conferred by Part II or Part III of the Act.

(ii) **Part II - Corporations at Risk**

Part II of the Act provides that where the Registrar has reasonable grounds to believe that any corporation is, or may be, a corporation to which the Act applies, he may give notice to that corporation stating that it is considered to be at risk. Such a corporation is forthwith required to consult with the Registrar who may give the corporation advice and assistance and, with the consent of the Securities Commission, may give specific directions with which the corporation is required to comply. The directions, which may not be expressed to apply for a period longer than 21 days, are aimed at preserving the interests of members and creditors. Under this part of the Act the Registrar can direct a corporation not to transfer or otherwise deal with any of its property (except with the Registrar's prior approval) and to place in a trust account any money received for investment.

(iii) **Part III - Statutory Management**

Part III of the Act contains the provisions of most significance to lenders. This part enables the Governor-General by Order in Council to appoint a statutory manager of a corporation to which the Act applies and specifies the powers of the statutory manager.

III. STATUTORY MANAGEMENT

(1) METHOD OF APPOINTMENT

Section 38 of the Act empowers the Governor-General by Order in Council to declare that any corporation and any associated person of that corporation is subject to statutory management, and to appoint one or more persons as statutory manager of that corporation. The appointment is for an indefinite period. The term "associated person" of a corporation is defined as any person who directly or indirectly controls the management of the corporation, any person who directly or indirectly owns 20% or more of the equity share capital of the corporation, and any person who is directly or indirectly controlled by the corporation. It also includes a person who is substantially indebted to the corporation.

The Act provides that the Governor-General may only act on the advice of the Minister of Justice, given in accordance with a recommendation from the Securities Commission. The Securities Commission is a statutory body established pursuant to the *Securities Act* 1978 which performs both a general watch-dog function and a law reform role in relation to all aspects of securities in New Zealand. The Securities Commission's power to make a recommendation under s 38 is subject to certain pre-conditions which reflect the objectives of the Act.

(2) EFFECT OF APPOINTMENT

The most significant effect of a corporation being declared subject to statutory management, is that a moratorium applies in respect of the corporation. During the period of statutory management, the Act provides in s 42 that no person shall:

(a) commence or continue any action or proceedings, including proceedings by way of counter-claim, against the corporation;

(b) issue any execution, attach any debt or otherwise enforce or seek to enforce any judgment or order obtained in respect of the corporation;

(c) petition or resolve to wind up the corporation;

(d) foreclose, enter into possession, sell, or appoint a receiver of the property of the corporation, or property in respect of which the corporation has an equity of redemption;

(e) exercise or continue any power or rights under or in pursuance of, any mortgage, charge, debenture, instrument, or other security over the property of the corporation;

(f) claim or recover, pursuant to any retention of title clause, hire purchase agreement, mortgage, lease, or security, any property in the possession of the corporation;

(g) determine or forfeit any tenancy, distrain for rent, retake or re-enter any premises, or exercise or continue any power or rights under, or in pursuance of, any lease, against the corporation;

(h) exercise any right of set off against the corporation.

The effect of the moratorium, is that the powers of creditors (including secured creditors) are placed in abeyance during the period of statutory management.

The statutory manager is granted very wide powers under the Act. These include:

(a) all powers, rights and privileges that the corporation has under any contract or otherwise;

(b) the powers of the members in general meeting and of the board of directors, in the case of a body corporate;

(c) all of the powers conferred on a liquidator under the *Companies Act* 1955 in relation to disclaiming onerous property;

(d) the power to carry on all or part of the business of the corporation (including all powers, rights and authorities necessary to carry on that business);

(e) the power to pay any creditor or class of creditors in whole or in part, and the power to compromise claims;

(f) the ability to terminate any contract of service or agency between the corporation and any person, notwithstanding the terms of such contract, with the effect that the corporation shall be discharged from further performance of such contract and all liabilities for subsequent non-performance of the contract;

(g) the power to sell or dispose of the whole or any part of the business of the corporation, without having to comply, unless the court otherwise directs, with the provisions of any agreement requiring consent, licence, permission or other authority prior to such sale;

(h) the power to sell any property or assets notwithstanding the existence or terms and conditions of any security over such property or assets in favour of any other person. However if any property or asset is subject to a fixed charge then the charge holder is entitled to be paid out of the proceeds of sale subject to payment of the costs of sale and certain preferential claims as on a winding up;

(i) the power to wind up or dissolve the corporation;

(j) the power to suspend, in whole or in part, the repayment of any deposit, the payment of any debt, and the discharge of any obligation. Any such suspension will not constitute a breach or repudiation of any contract entered into by the corporation.

In addition, the High Court may confer on the statutory manager such additional powers as it thinks fit.

In exercising his powers, the statutory manager is required to have regard to the interests of members, creditors and any beneficiaries under any trusts administered by the corporation, the public interest, the need to resolve the difficulties of the corporation, and as far as practicable, the need to preserve the business or undertaking of the corporation.

As can be seen, the scheme of the Act is to give total control of the corporation to the statutory manager and to place an embargo on creditors, members and other interested parties from taking any steps during the period of statutory management. The statutory management continues until it is terminated by Order in Council or until the corporation is wound up on the petition of the statutory manager.

(3) APPOINTMENT OF STATUTORY MANAGERS TO DATE

To date, the statutory management regime contained in the Act has been used in respect of three groups of companies:

(a) **Equiticorp Group**

The Equiticorp group of companies consisted of 148 companies across a diverse range of business activities. The gross value of the assets of the group at the time it was placed in statutory management was in excess of $1,500 million.

(b) **Richmond Smart Group**

By contrast the Richmond Smart group of companies was almost exclusively involved in property development. At the time the group was placed in statutory management it comprised 93 companies, with the approximate gross value of the assets of the group being $300 million.

(c) **Chase Group**

Only the property arm of the Chase group of companies was placed in statutory management. The property group comprised 110 companies having an approximate gross asset value of $1,100 million.

Both the Equiticorp group and the Richmond Smart group had statutory receivers appointed under the 1958 Act. However, both groups were declared by Order in Council to be subject to the new Act, following its enactment.

(4) ATTITUDE OF THE SECURITIES COMMISSION

The objects of the Act, as set out earlier in this paper, are very general in nature. Also there are inherent conflicts in having regard to the interests of the various parties referred to in the Act. Not surprisingly, the Act has been the subject of much criticism particularly from financial institutions and others involved in the taking of securities. To counter some of the criticism being levied against the statutory management regime, the Securities Commission in August 1989 published a statement detailing the Commission's attitude to the use of the regime.

The Commission stated that the three instances in which the Act had been applied to date provided a good illustration of the factors that the Commission would take into account in recommending that a corporation be made subject to statutory management. The factors which the Securities Commission identified were:

(a) each case involved a complex group of companies linked by shareholdings or inter-company debts;

(b) there were many creditors, unsecured or holding a range of different securities, affecting different companies in each group;

(c) in each case there was no security enabling the timely appointment of a receiver or manager for the group as a whole;

(d) there was a prospect of protracted litigation and expense to trace rights through each complex group;

(e) in the case of Equiticorp and Chase, there were vulnerable assets involved such as work in progress under construction or development contracts;

(f) the effect on the market in each case of an apprehension of unco-ordinated realisations of many assets in distress sales; and

(g) the effects of intervention and non-intervention upon the credit standing of New Zealand companies.

In addition, the Securities Commission stated that statutory management:

> "... enables independent experts to sort out unusually complicated affairs, and enables the interested parties, relieved from the apprehension of precipitate action by some, to consider means of resolving the difficulties of the company or group of companies. If the company or group can survive, statutory management enables the interested parties to work out the means of survival. If the company cannot survive, statutory management provides for decent burial respecting the interests of all claimants."

In considering the Securities Commission's statement, it is interesting to reflect on the origins of the Act and the use made by the Government of the preceding statutes. Earlier in this paper I mentioned the two groups of companies which led to the enactment of the 1934 Act and the 1958 Act, both groups involving issues of fraud or other questionable practices. The 1958 Act was used to appoint a statutory receiver a further 8 times prior to the Equiticorp group appointment. Here again the appointments came from public concern involving fraud or other questionable practices except for the case of the JBL group. This was a large group where a bank-appointed receiver exercised his powers in a way which was quite unnecessary to protect the bank's position and was causing significant losses to the group to the detriment of all other creditors. In these rather unusual circumstances a statutory receiver was appointed. Hence prior to the Equiticorp, Richmond Smart and Chase appointments the use of the statutory management regime was inevitably associated with issues of fraud or misconduct which could not be adequately dealt with by the normal legal processes.

The use of the Act in the Equiticorp, Richmond Smart and Chase situations involved a significant change in direction. The Securities Commission's statement clearly demonstrates that the Act can be applied where fraud or misconduct is not an issue. In the 3 cases referred to, basically for reasons of size and complexity, it was considered that the normal processes of law were inadequate and that the use of the Act was appropriate. In my view this represents a fundamental change in direction.

Further evidence of this change of direction can be seen from the approach of the Government to the collapse of the Securitibank group in 1976. The Securitibank group was probably the largest financial group operating in New Zealand at the time, apart from the major trading banks. Its shareholders comprised many of New Zealand's leading financial institutions. It was a very complex group with very complex issues. On the basis of the Securities Commission's statement, the Securitibank group would have been an obvious case for statutory management. Representations were in fact made to the Government to appoint a statutory manager based on the very grounds put forward by the Securities Commission. However the Government refused. Size and complexity and the difficulties that they cause were not seen as justifying the application of the Act. The law was allowed to take its normal course. It is interesting to note that there is little criticism of the ultimate outcome of the liquidation of the Securitibank group.

The Securities Commission in its statement also refers to statutory management as a means of enabling a group in financial difficulties to survive. The use of the regime as a "work out" mechanism is new. It was not contemplated in the 1958 Act. Even with the new Act the Minister of Justice in moving the introduction of the bill referred to its two broad purposes as follows:

(a) to enable action to be taken earlier in instances when a company is or may be operating fraudulently or recklessly; and

(b) to enable companies to be given a decent burial when ordinary remedies are inadequate.

With the Equiticorp and Richmond Smart groups, survival was never regarded as a possibility so that the application of the Act can only be seen as providing "the decent burial" referred to by the Commission. The Chase group is the first case where the appointment was clearly to assist survival. It was hoped that the moratorium resulting from the property group being placed in statutory management would prevent the difficulties of that part of the group causing the collapse of the group as a whole.

The Securities Commission's statement and the application of the statutory management regime to the Equiticorp, Richmond Smart and Chase groups are of significance in demonstrating a fundamental change in the purpose and use of the legislation. It is this change which has led to the current spate of criticism of the Act, particularly by financial institutions.

IV. IS THE ACT JUSTIFIED?

(1) EXISTING INSOLVENCY LEGISLATION

Whether or not the Act is justified must be seen in terms of its recent use and its purpose as outlined by the Securities Commission. The Commission's statement is clearly based on an assumption that the present insolvency laws in New Zealand are inadequate; inadequacy being no longer linked to fraud or similar cases but also arising out of size and complexity.

Certainly there are difficulties under New Zealand's insolvency legislation for complex groups that face financial difficulties. Receivership under a debenture is commonly used not only to obtain repayment for the debenture holder but also to enable, in appropriate cases, the planning and implementation of "work out" schemes. However this procedure has no application for large groups with unsecured lending based on negative pledges.

The scheme of arrangement in New Zealand has its difficulties. One of the main disadvantages of the present legislation is that there is no procedure for obtaining a moratorium on actions by creditors and members whilst an appropriate scheme is formulated, put to the parties and approved by the court.

In comparison liquidation procedures do include the ability to obtain the necessary moratorium through the appointment of a provisional liquidator. Furthermore there have been recent amendments to the *Companies Act* in New Zealand to assist some of the complexities that arise on the liquidation of a complex group of companies.

However the inadequacies of our insolvency legislation in New Zealand cannot be seen as a justification for the Act. The straightforward approach would be to amend and update the insolvency laws. Unfortunately the Government and the Securities Commission have seized on the statutory management concept and have utilised it in areas for which it was not originally designed, to overcome the difficulties under our present insolvency legislation with major corporate collapses. In New Zealand, therefore, with the statutory management regime we have:

(a) a procedure which is based on the use of the powers of the executive arm of Government;

(b) a procedure which had its origins in special circumstances involving fraud and has been extended to provide an alternative mechanism to the normal legal processes for insolvency, essentially because of size and complexity;

(c) a procedure which is not under the control of the courts.

A statutory management regime may be justified in some situations. For example such a regime is included in the *Reserve Bank of New Zealand Act* where the objective is to protect the financial system itself. This may well be an appropriate use of the regime. However it seems difficult to justify the regime where it is simply an alternative to normal insolvency procedures in the case of large and complex groups of companies.

(2) COMPLEXITY AS A JUSTIFICATION

The Securities Commission's statement in support of the statutory management regime sees the regime as enabling "independent experts to sort out unusually complicated affairs". The complexities exist whether or not a statutory manager is appointed. Furthermore it is questionable as to whether one or two experts at the top of the tree can produce all the expertise necessary to cope with the complexities that run through the total group. In any event the disadvantage of this approach is that one or two people are left to deal with a wide range of competing interests in circumstances where those interests are, in broad terms, unrepresented and unprotected.

There is no doubt that a real advantage of the statutory management regime is the moratorium that it imposes. However a moratorium does not need to be based on a statutory management regime but can easily be built in to insolvency legislation under the control of the courts.

Even if it is accepted that there are benefits in a centralised approach to the insolvency of a complex group, is this a justification for the imposition of a regime where total control is handed over for an indefinite period of time to managers who, in the main, can exercise extraordinarily wide powers free from any control from the courts? In complex commercial disputes all parties must still struggle within the normal judicial framework and there seems no reason why this should not be the position in the insolvency field, within a framework of proper and effective insolvency legislation. Furthermore, there is some support from the Securitibank case for suggesting that the difficulties of complexity, and the advantages of the statutory management regime in dealing with complexity, may be somewhat overstated.

(3) POLITICAL INVOLVEMENT

I have already referred to the use of the executive arm of Government in the statutory management regime. The appointment itself is by the Governor-General by Order in Council on the advice of the Minister of Justice given in accordance with a recommendation of the Securities Commission. The Minister of Justice may appoint an advisory committee by notice in the Gazette. The period of appointment, the appointment of additional members and the termination of the appointment of the committee, are all under the control of the Minister.

The Minister also has the power to terminate the appointment of a statutory manager for a range of reasons including bankruptcy and misconduct. In these circumstances, and in the case where the manager resigns, the new manager is also appointed by the Minister.

The status of statutory management can only be terminated by the Governor-General by Order in Council, except where it comes to an end by the winding up of the corporation on the petition of the statutory manager.

The courts have a very limited rôle apart from the usual power to interpret the legislation and determine whether the statutory manager is acting within his powers. There is provision for the statutory manager to apply to the court for directions and the court may also confer additional powers on the statutory manager. However the court has no supervisory role as to the conduct of the statutory manager.

It is difficult to justify the removal of the courts from the insolvency arena under the statutory management regime. What in effect has occurred is that normal day to day insolvency matters are left to the courts but the important issues arising from a major corporate collapse can be taken over by the Government and dealt with by the Government's statutory manager. In my view this approach is, in principle, quite wrong.

(4) INTERFERENCE WITH LEGAL RIGHTS

I have already emphasised the unlimited extent of the moratorium provisions and the all-embracing powers given to the statutory manager.

The effect on secured creditors is quite dramatic. They can take no steps whatsoever. Whilst they sit and watch, their security can reduce in value whether by reason of market forces or physical deterioration. The margin of security will continue to diminish as interest accumulates, which may ultimately cause a shortfall on ultimate realisation.

The secured creditors can only hope that the statutory manager will pay proper regard to their particular interests. However, as I have mentioned, the statutory manager must also take account of the interests of unsecured creditors, members and the public interest generally. The statutory manager is placed in an impossible situation trying to balance the interests of these competing groups. Actions which are for the benefit of unsecured creditors and members are almost certain to be actions which are detrimental to secured creditors. The interests of the members and the public interest may also be in conflict with the interests of secured and unsecured creditors.

The task that the basic principles of law are supposed to deal with, namely regulating the competing interests of differing groups, is the very task that is left to the statutory manager with no right being given to question or challenge his decision. In other words, the rule of law is replaced by a discretionary approach with the person exercising that discretion being uncontrolled by the courts and also, for that matter, by the Government. Even the removal of the statutory manager by the Minister of Justice has to be based on "disability, bankruptcy, neglect of duty, or misconduct, proved to the satisfaction of the Minister".

It is probably true to say that with an insolvent group, the whole approach of the Act implies that the task of the statutory manager is to maximise the proceeds from the realisation of the group's assets. This must inevitably be seen as resulting in an approach by the statutory manager which will be to the advantage of unsecured creditors and members at the expense of secured creditors.

Again it is difficult to see that there are benefits in the Act which justify its consequences and the very real disturbance of normal legal rights.

(5) EFFECT OF THE ACT ON FINANCIAL INSTITUTIONS

Institutions providing funds to any group which is "large and complex" must be seriously concerned with the Act and its use by the Government. It is not surprising that the international financial community as the provider of funds to New Zealand's major corporations, has reacted so adversely to the Act. These New Zealand corporations are, in turn, concerned about the detrimental effect on their ability to borrow and the rates and other terms of that borrowing.

The effect of the Act on securities is particularly dramatic. The lender to a major New Zealand corporation needs to judge the size and complexity of the group and the impact that its collapse is likely to have on creditors, members and the public interest generally. A security granted by a corporation which is of such significance as to raise concerns as to the impact of its collapse on the public interest, is of questionable value. The only time that the security will be called upon is likely to be the very time that a statutory manager will be appointed.

Even in the case of a group with unsecured borrowing, lenders will also see a significant disadvantage between the normal liquidation procedures and the uncertainty of the statutory management regime.

The consequences to New Zealand of the understandable reaction of the international financial community to the statutory management regime will, I trust, encourage the Government to review the Act and the way in which it is being used.

V. CONCLUSION

This paper has been presented as part of a session on "work outs". The only work out situation in which the Act has been applied is with the Chase group. Certainly with that group the Act provided an alternative to the scheme of arrangement procedure which would not have been a practical alternative for the group. However this simply highlights the present inadequacies of the insolvency legislation in New Zealand rather than justifying the statutory management procedure. I have referred to the very special circumstances dating as far back as 1934 from which the procedure evolved and I think it is unfortunate that it has developed into areas which should be governed by proper insolvency legislation under the control of the courts.

New Zealand has in the past pioneered legislation which is of interest and of assistance to other jurisdictions. In my view this is not the case with our statutory management regime, except perhaps as an illustration of a procedure which should not be imitated either in a "work out" or a liquidation situation.

Some may say that the Act reflects the faith that many New Zealanders have had over the years in Government involvement in numerous aspects of the New Zealand economy. It is however out of tune with the present extensive deregulation process by which the Government has tried to remove itself from as many parts of the New Zealand economy as possible. The Act smacks of the old "interventionism" and hopefully will be seen in that light and replaced by some new modern insolvency legislation which can cope with the collapse of large and complex groups of companies within the framework of the judicial system.