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Preferred claimants in a winding up.

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**Preferred claimants in a winding up: an overview of
statutory preferences in liquidations in New Zealand
and overseas**

**LLM Research Paper
Law of Bodies Corporate and Unincorporate
(Laws 523)**

**Law Faculty
Victoria University of Wellington**



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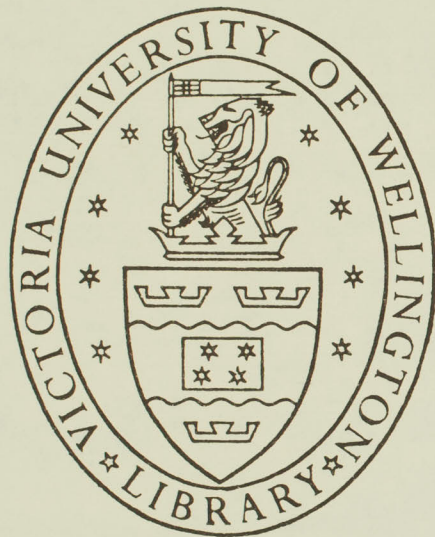


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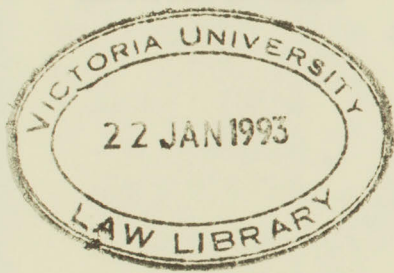


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The object of this paper is to consider present and proposed amendments to the Companies Act 1954 and to overseas Companies Act resolve identified structural problems? What other action is required?.....

The initial five chapters review the New Zealand regime in operation in the United Kingdom, Australia and the United States. While the overview shows that the "thrust" of all the regimes is similar it indicates differences in specific entitlements and general approach which provide options for reform, if it is decided to continue with a priority system.

In addition, however, the differences between the various regimes tend to highlight the lack of "logical consistency" in statutory preferences. Consequently chapter six of the paper aims to establish what the philosophical bases for existing preferences are and to question their appropriateness in the light of the principles of bankruptcy law, their economic impact and the Government's present economic and social policy.

While the paper concludes that the proposed reforms to the Companies Act will rectify some structural problems it is considered that a fundamental review of preferences in the context of general economic and social policy is required. If it is decided that there is a rational basis for continuing a priority regime then overseas systems need to be taken into account.

The text of this paper (excluding contents pages, headings, footnotes, bibliography and annexure) comprises approximately 16374 words.

ABSTRACT

The object of this paper is to consider present and proposed "statutory preference" law, in New Zealand and overseas, with a view to recommending possible short and longer term reform proposals.

The initial five chapters review the New Zealand regime in detail and consider how it compares with the systems operating in the United Kingdom, Australia and the United States. While the overview shows that the "thrust" of all the regimes is similar it indicates differences in specific entitlements and general approach which provide options for reform, if it is decided to continue with a priorities system.

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- Appendix I - Copy of Section 308 of the Companies Act 1955 and Rule 168 of the Companies (Winding Up) Rules 1956.
- Appendix II - Tabular form of provisions elaborating on prime provisions of Sections 261, 308 and Rule 168.
- Appendix III - Sixth schedule of the United Kingdom Insolvency Act 1986.
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INTRODUCTION

"Statutory Preferences" are important in liquidations¹ because if they apply in specific instances they reduce what is available to ordinary unsecured creditors². In New Zealand, as well as in some other jurisdictions³, statutory preferences can also reduce what is available to floating charge holders⁴.

In view of the impact of preferences, on creditors⁵, it seems to be imperative that the law is precise and accessible and founded on clear and acceptable philosophical bases. While both these needs appear to have been implicitly, if not explicitly, acknowledged by

¹ Statutory preferences are also important in other contexts e.g., receiverships but given that this paper is directed at liquidations those other contexts are only considered in a peripheral way.

² Statutory Preferences provide an exception to the pari passu principle of rateable distribution amongst unsecured creditors. Section 293 of the Companies Act 1955 clearly establishes that preferential payments constitute an exception to the pari passu principle.

³ Sections 101 and 308(4)(b) of the Companies Act 1955 provide that holders of debentures under any floating charge are to be paid out after Preferential Creditors. Similar provisions exist in the United Kingdom Insolvency Act 1986.

⁴ "If the assets available for payment of general creditors are insufficient to satisfy preferential debts, the shortfall can be taken from the assets under the floating debenture. If these assets have been realised by the debentureholder the liquidator can recover from the debentureholder the amount needed to pay outstanding preferential creditors". (Beck and Barrowdale, Guidebook to New Zealand Companies and Securities Law, p 342). See also Morrison's, Company Law, p 1427 paragraph 40-36.

⁵ If not also on the economy more generally e.g., the negative effects on floating charge holders could result in "non financing", financing in a different way; unsecured creditors could themselves be forced into liquidation, deterred from lending.

recent Companies Act Law reformers⁶ the relative complexities of the matter have meant that only minor changes have been proposed in the Companies Bill and the substantive review has been postponed meantime⁷. As explained by the Law Commission in Report Number 9 it had⁸:-

"resisted the temptation to rewrite the existing Rules on preferential debts. The Australian Law Reform Commission recommended major changes in the position of such preferential debtors as employees and the revenue authority. These are difficult and controversial matters which would apply to personal as well as corporate insolvencies and thus fall equally within the departmental review of the law of insolvency"

".... elected to leave the law on preferential claims unchanged for convenience, however, we have listed all preferential claims in Section 239. Other unsecured claims are governed by Section 240⁹".

Given that the proposed amendments in the Companies Bill relating to preferences have yet to become law, and that the substantive review by the Justice Department is ongoing, the general aim of this paper is to assess the present and proposed law with a view to indicating

⁶ See the Law Commission "Company Law Reform and Restatement Report No. 9" - (Wellington, 1989) and drafts of Companies Bill.

⁷ As indicated in the Law Commission's Report No 9 the Minister of Justice's terms of reference to the Law Commission mentioned that the "Department of Justice was engaged in a review of company liquidations as part of a wider review of the law of insolvency" (p 72)

⁸ Above n6, p 153, paragraph 651.

⁹ Above n6, p 164 paragraph 707.

whether/what short and longer term amendments would be appropriate. In order to make such an assessment it is necessary to initially establish¹⁰ what the existing and proposed regimes in New Zealand and elsewhere¹¹ are, and to consider what philosophical bases exist for those systems.

- (i) assets not belonging to the company e.g., secured creditors, suppliers of goods under contracts reserving title and creditors for whom the company holds assets on trust.
- (ii) assets available for distribution amongst unsecured creditors who have a claim on the basis of an exception to the pari passu rule (the pari passu principle provides that on a liquidation all creditors must participate in the common pool of company assets in proportion to their admitted claims¹²); e.g., those with rights of set off¹³, post-liquidation creditors, pre-liquidation debts paid to preserve assets or avoid loss¹⁴, claims which are given priority by statute¹⁵.

¹⁰ Farrar and Russell, *Company Law and Securities Regulation in New Zealand*, p 443.

¹¹ Above n12 p 443. In New Zealand section 293 Companies Act 1955 embodies principle. See also Goode, *Principles of Corporate Insolvency*, p 59. For recent developments - E. Fitzsimons, "Pari Passu and subordinated Debt" page 1; A.S. McMillan and Lockwood Ltd (in receivership and in liquidation, unreported Court of Appeal Decision 14 August 1990; Richardson J).

¹² In New Zealand section 93 of Insolvency Act 1967 criteria have to be established.

¹⁰ From the statutory provisions themselves and case law.

¹¹ reference will be made to the United Kingdom, Australian and United States jurisdictions.

I The Importance of Preferences generally to secured and unsecured creditors where a company is in liquidation in New Zealand

In looking at the distribution of assets in a liquidation it is possible to create four categories¹²:-

- (i) assets not belonging to the company e.g., secured creditors, suppliers of goods under contracts reserving title and creditors for whom the company holds assets on trust.
- (ii) assets available for distribution amongst unsecured creditors who have a claim on the basis of an exception to the pari passu rule (the pari passu principle provides that on a liquidation all creditors must participate in the common pool of company assets in proportion to their admitted claims¹³.) e.g., those with rights of set off¹⁴, post liquidation creditors, pre-liquidation debts paid to preserve assets or avoid loss¹⁵, claims which are given priority by statute¹⁶.

of what

Ranking of claims not assets

¹² Farrar and Russell, Company Law and Securities Regulation in New Zealand, p 443.

¹³ Above n12 p 442; In New Zealand section 293 Companies Act 1955 embodies principle. See also Goode, Principles of Corporate Insolvency, p 59. For recent developments E. Fitzimmons, "Pari Passu and subordinated Debt" page 1; A.G v McMillan and Lockwood Ltd (In receivership and in Liquidation, unreported Court of Appeal Decision 14 August 1990; Richardson J).

¹⁴ In New Zealand section 93 of Insolvency Act 1967 criteria have to be established.

¹⁵ Liquidator entitled to reclaim amounts from assets as costs of liquidation.

¹⁶ The focus of this paper.

(iii) assets available for distribution amongst unsecured creditors who have a claim on the basis of the pari passu principle of rateable distribution.

(iv) deferred debts which rank after ordinary debts have been paid¹⁷.

Not assets

Before unsecured creditors are eligible for repayment, however, creditors seeking payment under acts providing for specified debts to rank immediately after preferential debts and debts owing under floating charges need to be met.

In general terms the effect of the statutory priority/preference provisions in New Zealand is therefore to potentially reduce the "pool" available to unsecured creditors and floating charge holders. "Statutory preferences" clearly impact upon the distribution of assets amongst unsecured creditors by providing an exception to the pari passu principle. As commented by the Cork committee in the report of the United Kingdom

¹⁷ Farrar and Russell, Company Law and Securities Regulation, p 443 refers to 3 categories of deferred debt:-

(i) debt carrying interest in excess of 11% (only payable after ordinary debts paid in full)

(ii) interest bearing debts entitled to receive interest at agreed rate (rather than statutory 11%) between commencement of winding up and date of actual payment (when there is a surplus)

(iii) any debt or liability due to members.

See also pp 441-443.

Review Committee on Insolvency Law and Practice¹⁸:-

"It is a fundamental objective of the law of insolvency to achieve a rateable, that is to say pari passu, distribution of the uncharged assets of the insolvent amongst the unsecured creditors. In practice, however, this objective is seldom, if ever, attained.

In the overwhelming majority of cases, it is substantially frustrated by the existence of preferential debts. These are unsecured debts which, by force of statute, fail to be paid in bankruptcy or winding up in priority to all other unsecured creditors".

In addition, while statutory preferences do not generally affect assets "belonging to the company/belonging to secured creditors" they do affect assets secured by floating charges in so far as statutory provisions provide that preferential debts must be paid in priority to claims of holders under any floating charge¹⁹. This means that²⁰

"if the assets available for payment of general creditors are insufficient to satisfy preferential

¹⁸ Insolvency Law and Practice Review Committee Report (Cork Report) Paragraph 1396; Australian Insolvency Management Practice (Commerce Cleaning House Australia Ltd) Volume 1, p 4,652, in referring to the rule, comments that it is not uncommon for the "exceptions" to outweigh the rule, for the "exceptions" to exhaust all available assets.

¹⁹ Sections 101 and 308(4)(b) of the Companies Act 1955 provide that holders of debentures under any floating charge are to be paid after preferential creditors.

²⁰ Beck and Barrowdale, Guidebook to New Zealand Companies and Securities Law, p 342. See also Morrison's, Company Law, p 1427 paragraph 40-36.

debts, the shortfall can be taken from the assets under the floating debenture. If these assets have been realised by the debentureholder the liquidator can recover from the debentureholder the amount needed to pay outstanding preferential creditors". This is due in part to the fact that relevant provisions are not found in one Act but rather dispersed through a number of enactments¹¹. Further complexities arise because the main "preferential payments" provision (Section 308 of the Companies Act 1955) does not provide a "self contained" list of debts to be given priority¹² and the precise nature of the regime varies according to whether the Company has been wound up voluntarily or by the court¹³.

While the "voluntary" and "court ordered" regimes necessarily overlap the "voluntary regime" is to some degree a modification of the "court ordered" provisions. Consequently the regimes are probably more easily understood by referring to the court winding up provisions initially and subsequently explaining how those provisions are modified in a voluntary winding up.

(ii) An overview of the preference provisions in a Court Winding Up.

¹¹ They are found in the Companies Act 1955, The Companies (winding up) Rules 1956 and in the Companies (winding up) Fees Regulations 1984.

¹² While some debts are specified it also invokes, but does not specify, other legislation referring to appropriate priorities e.g., subsections (ca) and (d).

In addition other legislation provides that debts will be given a preference after section 308 preferences.

¹³ i.e., whether it has gone into voluntary liquidation, has been wound up by the court or has started to be wound up voluntarily but is subsequently wound up by the court.

II The existing "Statutory Preferences" regime in New Zealand where a company is in liquidation.

The current law relating to priorities and preferential payments in liquidations seems to be unnecessarily complex. This is due in part to the fact that relevant provisions are not found in one Act but rather dispersed through a number of enactments²¹. Further complexities arise because the main "preferential payments" provision (Section 308 of the Companies Act 1955) does not provide a "self contained" list of debts to be given priority²² and the precise nature of the regime varies according to whether the Company has been wound up voluntarily or by the court²³.

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Ignoring for the moment the impact of the common law the statutory preference regime can be regarded as being essentially established via a few "prime" provisions in the Companies Act and Companies Winding Up Rules, with "subsidiary" provisions elaborating on those "prime" provisions²⁴. Significant provisions in the regime are Sections 261 and 308²⁵ of the Companies Act and Rule 168 of the Companies (Winding Up) Rules.

In the case of a company which has gone into voluntary Section 261 provides the Court with the power to make an order as to what (and in which priority) costs, charges and expenses incurred in a winding up should be made when there are insufficient assets to meet liabilities. In all cases where the Court has not made such an order priorities are determined by the "Preferential payments" provision of Section 308²⁶ and the "Costs and expenses" provision of Rule 168²⁷. (A copy of the provisions is attached as Appendix 1. Provisions which elaborate on the "prime" provisions are needless to say numerous and are dealt with in tabular form in Appendix II²⁸).

In addition to the provisions within the Companies Act and Winding Up Rules providing preferences there are a number of other statutes which provide that debts owed will rank after the preferential debts in Section 308(1) and before

²⁴ The interpretation to be placed on these provisions has of course been developed via the common law and this will be dealt with later in this paper.

²⁵ Section 308 (1)(d) in turn refers to section 326A of the Companies Act 1955.

²⁶ Section 308 specifies what debts are to be given priority.

²⁷ Rule 168 refers to the Costs payable out of the assets of the Company in the specified circumstances.

²⁸ The cross reference provisions are largely taken (subject to verification and elaboration) from Anderson's Company and Securities Law in New Zealand.

floating charge holders. These statutes include the Income Tax Act 1976 (Section 365(2)(b) - PAYE Tax)²⁹ Goods and Services Tax Act 1956 (Section 42(2)(b))³⁰ and the Layby Sales Act 1971 (Section 11)³¹

(ii) An overview of the Preference Provisions in a Voluntary Winding Up.

In the case of a company which has gone into voluntary liquidation Section 299, in addition to Section 308 and Rule 168, is particularly relevant. The Section 308 priorities continue to apply with appropriate modification for the fact that the winding up is voluntary, rather than

²⁹ Provides an unlimited priority for PAYE deductions including withholding payments deductions (excluding penalties).

Farrar and Russell, "Company Law and Securities Regulation" pp 441-443 states that PAYE deductions rank behind the preferential debts of Section 308(1).

Section 365(2)(b) provides that PAYE has a priority "immediately after the debts referred to in section 308(1)". Subsection (2) provides that the tax is given priority over the claims of holders of debentures under any floating charge and subsection (4) defines floating charge in the same terms as section 308(7).

Anderson's, Company and Securities Law p 550 paragraph 308.09 refers to PAYE and Non-Resident Withholding Tax and possibly implies they rank after subsection (1)(a) and (b) whereas the provisions make it clear they rank after subsection (1).

³⁰ Provides an unlimited priority for GST payments which are unpaid to the commissioner (excluding penalties).

³¹ Provides that if there are no goods or not enough goods to enable the layby sale to be completed, or if a buyer is entitled to a refund upon cancellation of a layby sale, then the buyer is a preferred creditor. See Stein v Saywell (1969) 121CLR 529.

court ordered³².

Section 299 "Costs of Voluntary Winding Up" provides that:

"All costs, charges and expenses properly incurred in the winding up, including the remuneration of the liquidator, shall be payable out of the assets of the company in priority to all other claims³³".

Rule 168 provides for the situation where the company has initially commenced to be wound up voluntarily -

"168 Costs payable out of the assets -

(1) The assets of a company in a winding up by the court remaining after payment of the fees and expenses properly incurred in preserving, realising or getting in the assets, including where the company has previously commenced to be wound up voluntarily such remuneration, costs and expenses as the court may allow to a liquidator appointed in the voluntary winding up shall, be made in the following order of

³² e.g., where a voluntary winding up is succeeded by a compulsory winding up the 4 months period for which wages or salary can be claimed are the 4 months before the resolution to wind up: re Havana Exploration Co., Nathan's claim [1916] 1 ch 8 see Anderson's Company and Securities Law p 1 - 549.

³³ Emphasis added.

The priority, namely :-"³⁴

(iii) The preference provisions of Rule 168 of the Companies (Winding Up) Rules 1956 and Section 308 of the Companies Act 1955 in more detail.

Rule 168

While the introductory wording of Rule 168(1) is confusing it seems that in the case of a court winding up the "first calls" on the "assets"³⁵ of a company are the "fees and expenses properly incurred in preserving, realising, or getting in the assets" and any "remuneration, costs and expenses" which a court may allow to a previous liquidator who has been appointed voluntarily. The next calls on the "assets" are the other items listed in priority order in Rule 168.

³⁴ emphasis added.

(a) Anderson's, Company and Securities Law, p 10-56 paragraph 168.04, "costs incurred by a voluntary liquidator between the date of a resolution to wind up a company voluntarily and an order made on a petition for compulsory winding up, including costs in opposition to that petition, may be entitled to priority over other claims as falling within the word," "Fees and expenses incurred in preparing the assets" in the first part of r(168(1))."

(b) See also pp 10-56 paragraph 168.05 "where a members' voluntary winding up is superseded by a compulsory winding up by the court, the court is empowered under this rule to review the amount of remuneration of the voluntary liquidation fixed by the members of the company. Note the words of the first part of r168(1) and see re Mortimers (London) Ltd [1937] ch 289, 2ALLER 364. See also re Securities Ltd (No 10) an unreported judgment of Baker J (M1604 76) noted in 1978 current Law para 548".

³⁵ Assets have been held to be "free" assets e.g., Re Barleycorn Enterprises Ltd [1970] 2 AllER155.

The courts have been required to deal with numerous issues as to what exactly each of the pertinent words in the introduction of Rule 168(1) mean³⁶, individually and in combination. As a general comment, however, it can be said that it is accepted that provisional as well as liquidator expenses are included and that certain items are (in appropriate circumstances) accepted as being included e.g., such things as rent on premises a liquidator uses to store assets pending realisation³⁷, valuation fees, agent's commission, rates, insurance and power are covered³⁸. Similarly it appears that the Official Assignee's fees/commission, as provisional liquidator or liquidator, are also included as a "first

This is because clause 3 of the schedule to the Companies (Winding Up) Fees Regulations 1984 indicates that the fees are payable immediately after secured creditors i.e., "after deducting any sums paid to secured creditors out of the proceeds of or in respect of their securities".

Rule 167 of the Companies (Winding Up) Rules indicates these fees must be paid i.e., that it is mandatory. Rule 168 of these rules seems to indicate these fees take priority over the applying creditor's costs. That is, "the fees and expenses properly incurred in preserving, realising, or getting in the assets" (Rule 168(1)) include the fees lawfully and mandatorily (i.e., properly) prescribed in r 168.

³⁶ This will be discussed in detail in Chapter 4 dealing with the relevant case law.

³⁷ Re Downer Enterprises Ltd [1974] 2A11ER 1074.

Andersons, Company and Securities Law, p 10-56 paragraph 168.04 refers to a number of cases concerning what comes within the words "fees and expenses incurred in realising or getting in the assets" see, for example, Re Beni Felkai Mining Co Ltd [1934] Ch 406; Adler and Co Ltd [1935] Ch 138 and Re Circuit Developments Ltd [1981] 2NZLR 243.

³⁸ The list is endless according to the assets at issue e.g., general administration costs could include accounting fees, advertising, filing fees, insurance, legal fees, meeting room hire, motor vehicle hire, cost recovery, tolls and fares, removal costs, storage, travelling expenses, valuation fees.

call" on the "assets"³⁹.

While other expenditures are listed in Rule 168 some of the provisions are somewhat archaic and of doubtful relevance today. It would, for example, be rare for a special manager to be appointed⁴⁰ and it seems unlikely that in days of deregulation/decentralisation of government departments and the existence of individual accountability that the State Services Commissioner or the Minister would wish to be involved in giving a person

³⁹ This is because clause 3 of the schedule to the companies (Winding Up) Fees Regulations 1984 indicates that the fees are payable immediately after secured creditors i.e., "after deducting any sums paid to secured creditors out of the proceeds of or in respect of their securities".

Rule 187 of the Companies (Winding Up) Rules indicates these fees must be paid i.e., that it is mandatory. Rule 168 of these rules seems to indicate those fees take priority over the applying creditor's costs. That is, "the fees and expenses properly incurred in preserving, realising, or getting in the assets" (Rule 168(1)) include the fees lawfully and mandatorily (i.e., properly) prescribed in r 168.

New Zealand Company Law and Practice (Commerce Clearing House) takes a similar view - p 18,465.

It is assumed on the basis of this analysis that the reference in the subsequent "priority" list to "The remuneration of any such liquidator" is to any other liquidator apart from the Official Assignee.

⁴⁰ see S 257 of the Companies Act 1955 and r 31 of the Companies (Winding Up) Rules. Section 257 provides that the Official Assignee as liquidator can apply to the court for the appointment of a special manager with such powers "including any of the powers of a receiver or manager" as may be entrusted to him by the court.

Rule 31 states that an application for appointing a special manager be supported by a report of Official Assignee stating amount of remuneration

taking shorthand permission to retain their fee⁴¹.

Section 308

On its face Section 308 provides a priority for 5 categories of debt to rank equally amongst themselves and to be paid in full unless assets are insufficient, in which case they abate in equal proportions⁴². In effect, however, categories (a) (b) and (ca)⁴³ form a type of "subgroup" by virtue of Section 308 (2) providing that the total sum to which those provisions are to be given priority is not to exceed \$6,000⁴⁴ and subsection (d) opens a "floodgate" of priorities bestowed by other statutory provisions. In addition to subsection (d) providing a priority to sums required to be paid by Section 326A⁴⁵ a number of other statutes provide that

⁴¹ While r 52 indicates that the evidence can be taken down in shorthand or otherwise (i.e., appears to make way for new technology) the provisions relating to payment appear somewhat outdated e.g., subsection (3) provides for no more than \$5.00 a day and not exceeding 10 cents per folio for any transcript; (4) makes provision for an employee taking the transcript not being able to retain the funds without SSC or Minister's approval.

⁴² Section 308 has 5 subclauses; section 308(4) (a) provides for the specified abatement.

⁴³ Farrar and Russell "Company Law and Securities Regulation", pp441-443 summarises the priority provisions of s.308. In relation to S 308(1)(ca) it is stated "... by virtue of s.365(2) (b) of the Income Tax Act 1976 unpaid PAYE deductions rank behind the preferential debts" e.g., covers such things as union dues, Child Support Act 1992 payments.

⁴⁴ (a)(b) and (ca) can presently not exceed \$2,000.00 for any one employee where the date of winding up is before 10.10.88 and \$6,000 where the date of winding up is on or after 10.10.88.

⁴⁵ Section 326A(2) provides a priority of \$500 where but for the appointment of a provisional liquidator a lien could have been claimed in respect of services performed,

debts will be given a priority under Section 308 (1)(d). Included are the Volunteers' Employment Protection Act 1973⁴⁶, Apprenticeship Act 1983⁴⁷, Accident Compensation Act 1982⁴⁸, Radio Communications Act 1989⁴⁹ and Motor Vehicle Dealer's Act 1975⁵⁰.

Other important aspects of Section 308 are subsection (3) (which provides for the subrogation of employees' rights in respect of wages, salary and holiday pay where money has been advanced by some person for that purpose) and subsection (4)(b). Subsection (4)(b) provides that "preferential debts must be paid in priority to the claims of holders under any floating charge. If the assets

⁴⁶ The Act is concerned with volunteers in the armed forces. An employer is prohibited from dismissing an employee because they volunteer for "protected voluntary service or training". If an employer breaches this provision an employee can recover up to 16 weeks remuneration as compensation.

Section 2. See also R 11(1)(b) of the Emergency Forces Exceptional Re-establishment Regulations 1951.

⁴⁷ Section 23 provides that an apprentice may obtain an order from the court for wages (not exceeding 3 months) where they are deprived of employment they are entitled to under their contracts because a company has gone into liquidation

Section 23 also provides for payment when an employer has become bankrupt. Section 37 provides for similar payments to be made where a receiver is appointed.

⁴⁸ Section 58 provides that the first week's accident compensation (not exceeding \$1,500 for any one claimant) is a preferential payment.

⁴⁹ "An Act to provide for the management of the Radio Frequency Spectrum" (preamble) provides a preference (section 183) for various license fees which are outstanding when a company goes into liquidation.

⁵⁰ Provides that money to be paid out of the motor vehicle dealers' fidelity fund is preferential. When the Motor Vehicle Dealers Institute pays a claim against a defaulting motor vehicle dealer from its fidelity fund the Institute is subrogated to the claimant's rights against the dealer.

available for payment of general creditors are insufficient to satisfy preferential debts, the shortfall can be taken from the assets under the floating debenture. If these assets have been realised by the debentureholder the liquidator can recover from the debentureholder the amount needed to pay outstanding preferential creditors⁵¹

(ii) United Kingdom

Whereas in New Zealand Insolvency Law is contained in the Insolvency Act 1967 (individuals) and the Companies Act 1955 Insolvency Law in the United Kingdom (relating to individuals and companies) is contained principally in the Insolvency Act 1986⁵⁰. As is currently the situation in New Zealand winding up is now either voluntary or by the court⁵¹. Significant provisions in the Insolvency Act 1986, so far as preferences are concerned are Sections 175, 386 and the sixth schedule to the Act.

Section 175 "preferential debts"⁵² refers to preferential debts being as stated in Section 386 in Part XIX and provides, as in the case of Section 308(4) of the Companies Act 1955, that they will rank equally amongst themselves after the expenses of winding up and that they will take precedence before any floating charge. Section

⁵⁰ Prior to the commencement of that Act the law relating to individual insolvency was contained principally in the Bankruptcy Act 1914 while that relating to company insolvency was contained in the Companies Act 1945.

⁵¹ Previously there was also winding up under the supervision of the court.

Voluntary winding up is dealt with in sections 84 to 116; Compulsory dealt with under sections 117 to 162.

⁵¹ Beck and Barrowdale, Guidebook to New Zealand Companies and Securities Law, p 342; s 308(4)(b).

III The Statutory approach to preferences in other jurisdictions where a company has gone into liquidation - A "broad overview" of the regimes in the United Kingdom, Australia and the United States compared with New Zealand.

(i) United Kingdom

Whereas in New Zealand Insolvency Law is contained in the Insolvency Act 1967 (individuals) and the Companies Act 1955 Insolvency Law in the United Kingdom (relating to individuals and companies) is contained principally in the Insolvency Act 1986⁵². As is currently the situation in New Zealand winding up is now either voluntary or by the court⁵³. Significant provisions in the Insolvency Act 1986, so far as preferences are concerned are Sections 175; 386 and the sixth schedule to the Act.

Section 175 "preferential debts"⁵⁴ refers to preferential debts being as stated in Section 386 in Part XII and provides, as in the case of Section 308(4) of the Companies Act 1955, that they will rank equally amongst themselves after the expenses of winding up and that they will take precedence before any floating charge. Section

⁵² Prior to the commencement of that Act the law relating to individual insolvency was contained principally in the Bankruptcy Act 1914 while that relating to company insolvency was contained in the Companies Act 1985.

⁵³ Previously there was also winding up under the supervision of the court.

Voluntary winding up is dealt with in sections 84 to 116; Compulsory dealt with under sections 117 to 162.

⁵⁴ A general provision contained in Chapter VIII - Provisions of General Application in winding up.

386 "Categories of Preferential Debts"⁵⁵ is an equivalent provision to Section 308 of the Companies Act 1955 in so far as it states what the preferential debts of a company⁵⁶ are and makes reference to schedule 6 of the Act which lists the preferential debts in detail. The categories of preferential debts listed in Section 386 and referred to in detail in the sixth schedule are " money owed to the Inland Revenue for income tax deducted at source; VAT; car tax; betting and gaming duties; social security and pension scheme contributions; remuneration etc of employees; levies on coal and steel production".⁵⁷ (a copy of the sixth schedule is attached as Appendix III; A chart comparing the New Zealand provisions with Sections 175, 386 and the sixth schedule is attached as Appendix IV).

Similarities between the United Kingdom and New Zealand provisions include the fact that:-

- expenses apart from administration expenses rank equally and must be paid in equal proportions

(ii) Australia

- remuneration and holiday pay of employees are given a preference (although they are limited in the case of holiday pay to 4 months before the relevant date)

Differences include:-

- Income Tax is given a preference (although it is

⁵⁵ Contained in the Third Group of Parts "Miscellaneous Matters bearing on both company and individual insolvency: General Interpretation Final Provisions - Part XII - Preferential debts in Company and Individual Insolvency."

⁵⁶ and an individual.

⁵⁷ section 386.

limited to 2 months prior to liquidation, there is no such preference in New Zealand)

- PAYE is given an equivalent preference to Income Tax and they can be offset against each other (In New Zealand PAYE has a preference following the Section 308(1) preferences)

Explain

- VAT has an equivalent preference to Income Tax, and is limited to 6 months (GST has a preference following the Section 308(1) preferences but no time limit is imposed)

- there are a number of areas where no comparison is possible. They relate specifically to the United Kingdom circumstances e.g., car tax, betting and bingo duty, contributions to occupational pension schemes, Reserve Forces (Safeguard of) Employment Act, Levies on coal and steel production

any counterpart to MUSA? by statute

What about floating charges

(ii) Australia

The Australian regime, unlike the system operating in the United Kingdom, retains separate legislation for corporate and individual insolvencies.

As with New Zealand the Corporations Act 1990 (the equivalent to the Companies Act 1955) provides for schemes for distributions of assets which vary slightly depending on whether the company is being wound up voluntarily or by the court. In both instances, however, any distribution is subject to the general principle of pari passu distribution and the provisions of the Corporations Law as to preferential payments⁵⁸. Section 501, which relates to

⁵⁸ Chapters of the Corporations Law deal with liquidation matters.

voluntary winding ups, provides that⁵⁹:-

"subject to the provisions of this law as to preferential payments, the property of a company shall, on its winding up, be applied in satisfaction of its liabilities equally and subject to that application, shall, unless the articles otherwise provide, be distributed among the members according to their rights and interests in the company"

Section 555, relating to liquidations generally provides that "Except as otherwise provided by this law, all debts proved in a winding up rank equally and, if the property of the company is insufficient to meet them in full, they shall be paid proportionately (pari passu)."⁶⁰

The corporate system varies from the United Kingdom and New Zealand statutory provisions in so far as the Australian Corporations Act also provides for priorities of registrable charges, including registered floating charges, on the property of a company in Section 279.⁶¹ By virtue of subsection (3) of Section 279 floating charges are generally deemed to rank behind fixed charges

⁵⁹ Section 501 applies only to a voluntary winding up and not to winding up by the court Re Walker Construction Co. Ltd (1960) NZLR523; see Australian Insolvency Management Practice (Volume 1)(C.C.H) pp 234.001-234.221 for general discussion regarding section 501. Section 512 provides that proper costs, charges and expenses of and incidental to a voluntary winding up are payable out of the property of the company in priority to all other claims Section 485 refers to those entitled in a court winding up.

⁶⁰ Section 555 of the Corporations Act 1990 see Australian Insolvency Management Practice (volume 1) (C.C.H) for discussion.

⁶¹ Part 3.5 of the Act deals with charges. Division 1 (preliminary) Division 2 (registration), Division 3 (order of priority).

that are created before the floating charge being fixed⁶².

Despite the degree of commonality provided for fixed and floating charge holders through Section 279 of the Corporations Act specific provision is made in Section 561 to benefit some preferential creditors over floating charge holders. Section 561 provides that the Section 556 preferential unsecured debt priority payments of leave of absence or retrenchment payments, whether subrogated or otherwise, are to take preference over floating charge holders⁶³.

⁶² Exceptions to this general rule are provided for in ss 279(3)(a) and (b) i.e., a floating charge is not postponed to a fixed charge where:-

"(a) the creation of the subsequent registered charge contravened a provision of the instrument or resolution creating or evidencing the floating charge; and

(b) a notice in respect of the floating charge indicating the existence of the provision referred to in paragraph (a) was lodged with the Commission under section 263, 264 or 268 before the creation of the subsequent registered charge...."

⁶³ Whereas in New Zealand and the United Kingdom all preferential creditors are preferred over floating charge holders.

When a company has given a floating charge over its assets to secure a creditor, and there is insufficient property available to the company for payment of both that secured creditor and those creditors claiming priority for wages, leave of absence, or retrenchment pay whether subrogated or otherwise, then the wage or leave of absence, or retrenchment pay creditors must be paid in priority to the claims of the secured creditor and may be made out of the property comprised in or subject to the charge (section 556).

The priority repayment of employees extends to cover any employee entitlements referred to in subsection 558(3) or (4) deemed to be a cost of winding up by virtue of section 561(b). For these purposes, as much of the assets subject to the charge as are needed to satisfy these particular claims become "available" to the company.

In addition the Crown Debts (Priority) Act 1981 provides a priority to specified tax payments, which surpasses statutory preferential debts, except administrative costs and expenses⁶⁴, and unsecured debts generally. Section 4 of the Crown Debts (Priority) Act provides that nothing in the Corporations Law affects the operation of Sections 221P, 221YHJ, 221YHZD or 221YU of the Income Tax Assessment Act 1936⁶⁵.

These sections impose duties on Trustees to account to the Commissioner for PAYE deductions, non-resident withholding tax payments, prescribed payments and dividend and interest withholding tax payments. In the case of non-resident withholding tax penalties which are imposed via Section 221YH2D and 221YHJ are also payable by the Trustee to the Commissioner. Each of the provisions provide that while amounts payable under each section have priority over all other debts "whether preferential, secured or unsecured", they rank equally with each of the tax priority payments⁶⁶. While it is stated that as well as

⁶⁴ The Act also provides that nothing in the provisions gives the specified payments priority over any costs, charges or expenses of the winding up of the company (including costs of a creditor or other person upon whose petition the winding up order was made and remuneration of the liquidator except where the state, Crown or any other creditor is entitled to payment in priority to the costs and does not waive that priority.

⁶⁵ See Australian Corporations and Securities Law Reporter (Commerce Clearing House Australia Ltd) p 243,964 for general discussion.

It should be noted that there has been a removal of the crown priority in other areas of Taxation. The Australian Companies Code (section 441) also provided a preference for land tax and income tax (to 1 year's assessment).

⁶⁶ Above n65; the priority also overrides the court's statutory power under section 564 to vary the distribution of property among creditors "to reflect their contribution to its recovery".

being a priority over preferential creditors there is a priority over secured creditors it appears that the Crown's priority does not in fact exist where a security enables the creditor to be paid outside the liquidation⁶⁷.

A copy of Section 556, setting out the priority for payment of preferential unsecured debts, is attached as Appendix V. A chart comparing the New Zealand and Australian provisions is attached as Appendix VI. Similarities between the Australian and New Zealand provisions include the following:-

- both give a priority to costs, charges and expenses of winding up (although the Australian provision specifically differentiates between liquidator and provisional liquidator costs and provides for Official Management/Administration costs to be met in specified circumstances)⁶⁸
- both provide a preference for outstanding wages, holiday pay and accident compensation/injury compensation (whereas New Zealand does not differentiate employees generally from Directors, Director's spouses and relatives of employees, and sets a maximum amount, this is not the case in Australia. The Australian legislation distinguishes between employees

⁶⁷ Australian Corporations and Securities Law Reporter (CCH) p 243,964 e.g., section 221P of the Income Tax Assessment Act only gives a priority to the Commissioner where property has come under the control of the trustee of the company. Trustee is defined to include "...executor or administrator, guardian, committee, receiver or liquidator" but does not include a provisional liquidator.

⁶⁸ The Law Reform Commission Report No 45 (Harmer report) paragraph 717 supported this priority on the basis that creditors have a community of interest in having a common agent to maximise the fund.

generally (where no limit of amount is set) and Directors and director related parties (where limit of amount is set)

Differences between the two regimes include the following:-

- priority payments are rendered in the order they are to be paid, rather than providing that they will rank equally and must be paid in equal proportions
- PAYE and withholding tax payments are given a higher priority than other preferences and in the case of withholding tax payments include penalties. In New Zealand tax preferences come after the general Section 308 priorities and penalties are not included as a priority.
- retrenchment/redundancy payments are given a priority in Australia but not in New Zealand.

(ii) United States

The law relating to bankruptcy (individual and corporate insolvencies) is codified and enacted as Title eleven of the United States code and titled "Bankruptcy"⁶⁹. There are eight Chapters within Title eleven⁷⁰ and while Chapter five is particularly relevant so far as priorities and preferences are concerned other Chapters also contain

⁶⁹ Cited as 11USC

⁷⁰ Titled General Provision⁽¹⁾, case Administration⁽³⁾ Creditors, the debtor and the Estate⁽⁵⁾, Liquidation⁽⁷⁾, Adjustment of debts of a Municipality⁽⁹⁾, Reorganisation⁽¹¹⁾, Adjustment of debts of an individual with regular income⁽¹³⁾, United States Trustees⁽¹⁵⁾.

pertinent provisions⁷¹.

As with the other jurisdictions previously discussed one section of the code (507) makes provision for priority to be given to specified unsecured claims in this case in the priority order given. A first priority is given to administrative expenses (which are dealt with in detail in the previous Section 503) and other priorities are given to "wages, salaries or commissions, including vacation, severance and sick leave pay", (deposits paid for the "purchase lease or rental of property or the purchase of services" and various taxes⁷² (A copy of Section 507 is attached as Appendix VII; A chart comparing the New Zealand and United States provisions is attached as Appendix VIII).

While there is no provision exactly equivalent to Section 308(4) of the Companies Act, providing that in the event of there being insufficient assets to meet preferential creditors then those debts will be paid out of property covered by floating charges, Section 547 operates to subrogate floating charges in circumstances where unsecured creditors would otherwise be prejudiced. Other differences between the United States jurisdiction and the others that have been considered stem from the fact that tax and customs and excise claims, in particular, are given an even stronger priority. This occurs by virtue of tax liens being able to take priority over preferential

this is equivalent to s. 309.

⁷¹ E.g., definitions of lien, and security interest in general provisions.

⁷² There are six separate categories. Taxes for certain increase or gross receipts taxes, property taxes, taxes required to be withheld and collected and for which the debtor is liable in any capacity, employment taxes imposed on an employer, excise taxes including estate and gift taxes, pecuniary loss penalties.

See Norton, Bankruptcy Law and Practice, Part 40, for general discussion.

creditors (including unsecured claims for taxes)⁷³ and by virtue of code 523 providing "exceptions to discharge" in specified cases.

In general terms the Code contains a mechanism for determining claims for secured⁷⁴ and unsecured debt and provides that in cases where the extent of the creditor's security or set off is less than the allowed claim then the remainder of the debt is unsecured⁷⁵. The initial step in the process is for all secured and unsecured creditors to file proofs which are deemed allowed unless a party with an interest objects, in which case the court

⁷³ Tax liens are created by 26 United States Code 6321. See United States Code Annotated discussion re taxes as a priority under section 507, pp 265-267 and discussion about taxes generally pp 329 to 346.

⁷⁴ Charge holders are defined as lien holders for the purposes of the Code Section provides the following relevant definitions:-

"lien" means charge against or interest in property to secure payment of a debt or performance of an obligation.

"security" includes

"security agreement" means agreement that creates or provides for a security interest.

"security interest" means lien created by an agreement.

⁷⁵ Section 506 "(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to set off under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to set off, as the case may be, and is an unsecured claim to the amount so subject to set off is less than the amount of such allowed claim.

....."

will determine the matter⁷⁶. (As previously indicated the Trustee in bankruptcy has the power to avoid otherwise perfected transfers of property by virtue of Section 547. The trustee also has the power under Section 544 to avoid imperfect transfers). Once it is determined that a creditor has an allowed secured claim⁷⁷ then Section 506 provides, amongst other things, the mechanism for determining the extent of the security vis a vis any unsecured claim - for the payment of any interest, fees or charges owing to the charge holder and for the recovery by the trustee of "the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim".

Sections 544 and 547 of Title eleven of the United States Code

Sections of the Code which are particularly relevant in determining whether or not a creditor has an allowed secured claim are Section 544 (Trustee as lien creditor and as successor to certain creditors and purchasers) and Section 547 (preferences). Section 544 gives the Trustee the power to avoid any transfer of property of the debtor either in his capacity as Trustee or in the capacity of "hypothetical lien creditor" which is bestowed upon him by Section 544(a)⁷⁸. Norton Bankruptcy Law and Practice

⁷⁶ Or an entity that is liable to such credit or with the debtor, the debtor or the trustee (section 501). Section 501 also provides that an equity security holder may file a proof of interest.

⁷⁷ Section 506 provides that if a claim is not an allowed secured claim then such a lien is void unless specified requirements are met.

⁷⁸ Section 544 also enables the trustee to assume the rights of hypothetical third parties/bonafide purchaser of property by virtue of section 544(a)(3).

See Norton, Bankruptcy Law and Practice, Part 30, pp 3 to 12 for general discussion.

summarises Section 544 as follows: Section 547(c)

"Code 544 functions to avoid any unperfected security interest. Beyond this the hypothetical lien creditor status in Code 544 also allows the trustee to avoid a wide variety of unfiled, imperfectly filed and incomplete transfers of interests"⁷⁹.

In general terms Section 547 enables the Trustee to avoid transfers of property by the debtor made within 90 days of bankruptcy, or in some cases during the 90 days to one year period, where the subcode (b) conditions are met:-

- (i) transfer of property of debtor
- (ii) to the benefit of a creditor
- (iii) on account of an antecedent debt
- (iv) within 90 days of bankruptcy (or within one year if the transfer is to an insider⁸⁰)
- (v) while the debtor was insolvent
- (vi) with the effect of giving the creditor a greater return on debt than would have been the case if the transfer had not taken place.

There are, however, specified exceptions to the trustee's

⁷⁹ Above n78, p 11. The limits of the provision are also referred to. The section does not give the Trustee the power to avoid a security interest where filing is delayed but occurs before the petition is filed. Such security interest may, however, be subject to attack as a voidable preference or as a fraudulent conveyance.

⁸⁰ "Insider" is defined in s 101 to include, in the case of a corporation, director of the debtor, officer of the debtor, person in control of the debtor,

"avoidance" powers⁸¹ provided for in Section 547(c).

So far as priority payments are concerned issues of importance that have arisen in this context have been whether or not tax payments, and payments under service and wage contracts, are preferences or whether they are protected under 547(C)(2). In addition the issue of whether or not a floating charge (perfected security interest in inventory or receivable by 547(5)) is protected from avoidance has arisen.

It appears that estimated taxes and withholding taxes can not constitute preferences because the former are a prepayment of taxes and the latter the payment of a current tax liability which are not an account of an antecedent debt. While other timely (made when due or under "an extension") payments of taxes may constitute preferences it seems that Section 547(C)(2) protects such taxes from avoidance in so far as it protects payments of debts incurred in the ordinary course of business⁸², made not later than 45 days after the debt was incurred, made in the ordinary course of business and made according to ordinary business terms. Unless there is a pre-existing tax lien late payment of taxes attaching a penalty would not be protected under the section because it can not then be said that the payment was not made in the "ordinary course of business".⁸³

So far as service and wage contracts are concerned the

⁸¹ It is stated in the definition part of section 547, 547(a) "a debt for a tax is incurred on the day when such tax is last payable, including any extension, without penalty".

⁸² 2(A) and (C) also refer to debts incurred in the ordinary course of the financial affairs of the debtor and the transferee.

⁸³ Norton Bankruptcy Law and Practice, Part 30, p 61.

issues under Section 547 have included:-

(i) whether or not there is an antecedent debt, whether the "debt is incurred as services are performed and a right to enforce payment arises or whether the debt is not incurred until the contracted date for payment arises"⁸⁴

(ii) whether or not there has in fact been a preference.

Arguments in support of such wage payments being protected have included the views that:-

(i) there could not be a preferential effect if the wage earner were entitled to a priority distribution under the act and would have received a full payment and that

(ii) timely payments of wages are not preferences because they do not constitute antecedent debts, the claims do not arise until the contract payment date arrived.

While it again appears that most timely wage payments will be protected late payment could mean that such payments were not in the ordinary course of the debtor's business as required by 547(2) (A).

Provision for Tax Liens

The clear distinction between the treatment of secured and unsecured claims which is provided in the code also extends to the area of unpaid taxes.⁸⁵ In addition to

⁸⁴ Above n83

⁸⁵ Section 506

Section 507 providing priority for a number of unsecured tax claims, tax liens are able to take priority over preferential creditors, including unsecured claims for taxes⁸⁶.

Specific unsecured tax claims having protection and priority include not only taxes which an employer/trustee is required to withhold from the pay of an employee, such as the employees' shares of social security and Federal unemployment insurance⁸⁷, but also various property taxes, excise taxes and customs duty. There are also provisions permitting penalties relating to tax and other claims referred to in paragraph 6 to be given priority⁸⁸ and to prevent taxpayers taking an advantage of loopholes which would otherwise enable them to escape their taxation liabilities. Section 507(a)(6), for example, provides a priority for a tax on income or gross receipts for a "taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition."

The reason for such a priority appears to be to prevent taxpayers filing in bankruptcy to avoid the Inland Revenue Service being able to pursue negotiations over a tax audit or litigation in the Tax Court. i.e., the tax law prohibits the service's right to assess a tax deficiency

⁸⁶ See United States Code Annotated (volume covering sections 501 to 503) discussion re taxes as a priority under section 507, pp 265-267 and discussion about taxes generally pp 329 - 346.

⁸⁷ And in this respect are analogous to other jurisdictions.

⁸⁸ This is in contrast to the New Zealand situation where only the "substantive" amount and not additional penalties are given priority. The provision of a priority for rental of property payment in s 507(5) is also unique to the United States provisions.

until after the service sends the taxpayer a deficiency letter or until the outcome of the litigation. Some taxpayers exploited the loophole by filing in bankruptcy immediately the deficiency letter is sent or after the court proceedings. This section preserves a priority for taxes "the assessment of which was barred by law by giving the tax authority [3 years] within which to make the assessment after lifting of the bar⁸⁹.

" Thus if a taxpayer files a title 11 petition at any time during that [3 year period], the tax deficiency will be entitled to priority. If the petition is filed more than [3 years] after the restriction on assessment was lifted, the taxing authority will not have priority for the tax deficiency".

Similarly Section 507(6)(A)(ii):⁹⁰

"closes a loophole under present law under which, following an assessment of tax, some taxpayers have submitted a formal offer in compromise, dragged out negotiations with the taxing authority until the tax liability would lose priority under the three year priority period of present law, and then filed in bankruptcy before the governmental unit could take collection steps."

Whether or not a tax lien takes priority over other secured creditors or preferential creditors is dependant

⁸⁹ United States Code Annotated (volume covering sections 501 to 503) p 265.

⁹⁰ Above n89 Section 507(6)(A)(ii) provides "assessed within 240 days, up to any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or"

on whether it is in fact a valid security⁹¹. Once it is established that a tax lien is a valid allowed claim in terms of Section 506 then any question of priority arises in the context of relative priorities of specific tax liens and secured creditors generally. Questions, for instance, of whether federal tax liens take precedence over state liens⁹²? whether a state lien which has been perfected earlier in time takes precedence over a federal lien⁹³?

Other differences between the United States Code and other jurisdictions

Section 523 of the Code places the Inland Revenue Service and the Collector of Customs in a strong position in providing for an "exception to discharge":-

- "(i) for a tax or a customs duty -
 (A) of the kind and for the periods specified in Section 507(a)(2) or 507(a)(6) of this title, whether or not a claim for such tax was filed or

very important

⁹¹ Above n89 page 294 reference is made to Phoenix Indem Co v Earle CA Or 1955, 218 F2d 645.

In bankruptcy proceedings perfected tax "liens" take preference over "priority" claims of labourers and material when unsupported by lien".

⁹² Above n89, p 294 reference is made to California State Department of Employment v US CA Cal. 1954, 210 F2d242

⁹³ Above n89, p 294 reference is made to e.g., United States v Sampsell, CCA Cal 1946, 153 F2d 731 "Liens of the United States against bankrupt's estate for unpaid gasoline taxes were not entitled to priority in payment over the inchoate general liens of the state of California for franchise taxes which antedated the liens of the United States".

allowed"⁹⁴. While debtors are discharged from their bankruptcy they remain liable for the debts which are specified in the provision.⁹⁵

Other differences in the United States approach include the fact that specific provision is made under Section 503 "Allowance of administrative expenses" for costs and expenses incurred during administration, whether incurred during the reorganisation period or during liquidation. Section 503(b)(3), for instance, provides that actual and necessary expenses of creditors and others who have made a substantial contribution in a case under Chapter 9 (Adjustments of debts of a Municipality) or Chapter 11 (Reorganisation) are to be met. Subsection (4) provides that reasonable compensation for professional services rendered by an attorney or an accountant can be provided for and subsection (5) enables reasonable compensation to

⁹⁴ Section 523(a)(1). Section 523(a) provides that the obtaining of a discharge under other sections of the legislation - Section 727 (Discharge in Liquidations), section 1141 (dealing with the discharge of individual debtors who have filed plans) - does not discharge the debtor from the specified debts.

⁹⁵ United States Code Annotated (volume covering sections 501 to 503) p 99

Also included in the non-dischargeable debts are taxes for which the debtor had not filed a required return as of the petition date, or for which a return had been filed beyond its last permitted due date.

Tax claims with respect to which a debtor filed a fraudulent return, entry or invoice, or fraudulently attempted to evade or defeat any tax are included as are tax payments due under an agreement for deferred payments of taxes which a debtor had entered into with the IRS before the filing of the petition and which relates to a prepetition tax liability.

These categories of non dischargeability apply to customs duties as well as to taxes.

be made to an indenture trustee who has made a substantial contribution in a case under Chapter 9 or 11. It has been accepted that "Actual and necessary costs" entitled to priority should include costs ordinarily incident to the operation of a business and not be limited to costs without which rehabilitation would be impossible⁹⁶.

(iv) Summary of the Comparison between the New Zealand, Australian, United Kingdom and United States Provisions

As indicated above there is a major difference between the United States preference regime and others in so far as the former has a specific provision avoiding floating charges in circumstances where unsecured creditors would otherwise be prejudiced, provides for tax liens to be given priority over and above the numerous unsecured tax and excise duty priorities and provides that the priority debts are non dischargeable debts. The Australian regime also varies significantly from the others in that it only provides for priority to be given over floating charge holders in respect of wages, leave of absence or retrenchment pay⁹⁷

SD does
NZ
—

General similarities between the jurisdictions are as follows:-

- Australia and the United States provide for ranking order whereas New Zealand and the United Kingdom give priority to administration expenses but provide that other priority payments are to

⁹⁶ Reading Co v Brown, P.A 1968, 88 5 ct 1759, 391 US 471, 20L Ed 2d 751 referred to at p 302 United States Code Annotated (volume covering sections 501 to 503).

⁹⁷ In addition the fact that the United States and United Kingdom have an "all inclusive" Insolvency Code, rather than separate individual and corporate codes is significant, although beyond the scope of this paper.

rank equally and must be paid in equal proportions.

- while details vary all provide a preference for outstanding wages and holiday pay.
- taxes and excise duties of varying kinds are given priority as unsecured debts, although the specific nature and extent of the priority varies. For example, New Zealand gives a "delayed priority" (after Section 308 preferences but before floating charge) to GST and PAYE tax whereas the United Kingdom gives a preference to Income Tax, PAYE, and VAT. Australia provides a priority to specified tax payments (PAYE, Non Resident Withholding tax, dividend and interest Withholding tax payments) which surpasses statutory preferential debts, except administrative costs and expenses and unsecured debts generally. The United States, on the other hand, gives different priorities to different taxes e.g., taxes incurred during the administration of the estate are given first priority; "employers' share of employment taxes on wages earned from the debtor before the petition but paid from the estate after the petition has been filed receives either sixth priority or general claim treatment." Income Taxes, profit taxes, employees' share of social security taxes held by employers also share sixth ranking priority.

General differences which are evident include:-

- outstanding wages and holiday pay - whereas New Zealand does not differentiate employees generally from Directors, Directors' spouses and

IV. Case relatives of employees Australian legislation distinguishes between employees generally and the latter group.

(i) Case - retrenchment/ redundancy payments are given a priority in Australia and in the United States, but not given any priority in the United Kingdom⁹⁸ or New Zealand.

(ii) Case - income tax is not given any priority in New Zealand whereas it is, to different degrees in the United Kingdom (limited to 12 months prior to liquidation) and the United States.

(iii) Case - all contain priorities which are "peculiar" to their own countries'/legislation in their countries.

(iv) Case - provision is made for costs and expenses incurred during periods of Administration to be met in the Australian and United States related jurisdictions.

⁹⁸ In the United Kingdom however provision is made in the Employment Protection (Consolidation) Act for such payments.

IV Case law on priorities and Preferences when a company has gone into liquidation - Case law's "impact" on the statutory provisions and how it highlights possible areas for reform

(i) Case law in New Zealand

The "focus areas" of priorities' case law are reasonably small, although in addition to indicating areas where the law is settled they provide some insight into possible areas for reform⁹⁹. General areas that have been the subject of case law have included "what constitutes a cost, charge or expense incurred in a winding up"¹⁰⁰, what constitute "assets"¹⁰¹ of the company and when in comparison to expenses, should a liquidator's remuneration be paid?

In the context of Section 308 itself the bulk of litigation has centred on the terminology used in subsections (a) and (b), relating to the preference for wages, salary and holiday pay. Other issues arising have related to the priority of Sales Tax and PAYE tax.

What constitutes a cost, charge or expense incurred in a winding up?

Some confusion has arisen in respect of these terms as a consequence of the slightly different contexts they are used in in Sections 261 and 299 and Rule 168, and the fact that the relationship between those provisions is

⁹⁹ In view of similarities in systems United Kingdom cases have applied directly to New Zealand.

¹⁰⁰ For the purposes of voluntary or court windings up, in the context of s 261 compared with 299; in the context of r 168 of the Companies (Winding Up) Rules? or their English equivalent provisions.

¹⁰¹ For the purposes of ss 261, 299 and r 168?

uncertain¹⁰². Despite these differences the provisions can generally be treated as synonymous for the purposes of establishing what cases have considered constitute "costs, charges and expenses", although differences of context can have some impact and need to be acknowledged.

Expenditure which has been held by the courts to constitute fees and or expenses properly incurred in preserving, realising or getting in the assets includes costs incurred by a voluntary liquidator in opposing a

compulsory order with the usual order as to costs was made. The voluntary liquidator appeared on the petition in opposition to it. On the taxation of costs the registrar disallowed certain items of costs incurred by the liquidator after the resolution but before the petition was heard, including the costs of consultations by the liquidator and of obtaining counsel's opinion. The solicitor to the liquidator then brought in a further bill of costs, including items disallowed on the previous taxation, but allowable as a taxation between solicitor and client. The court held that the costs incurred by the voluntary liquidator were payable out of the assets of the company.

¹⁰² e.g., while s 299 clearly relates to voluntary liquidations it is not clear whether s 261 does. Does r 168 apply to voluntary liquidations or only to ones where there has been an initial or subsequent winding up by the court?; while ss 261 and 299 refer to costs, charges or expenses. r 168 refers to fees and expenses initially and then subsequently refers to remuneration costs and expenses.

See Webb v Whiffen (1872) LR 5AL 711 at 735 for the reasons for the difference between sections 261 and 299.

Differences include - whereas s 261 refers to ".... costs, charges, and expenses incurred" s 299 refers to ".... costs, charges and expenses properly incurred including the remuneration of the liquidator whereas section 261 gives the court the power to make an order of priority as it thinks just section 299 provides that "All costs, charges and expenses shall be payable". Anderson's Company and Securities Law paragraph 299-05 concludes that the court may also order payment of remuneration in priority to other costs, charges and expenses incurred in the winding up by exercising under s 298 the power given by s 261.

successful petition for compulsory winding up¹⁰³, rental of premises occupied by a company in liquidation¹⁰⁴ and

¹⁰³ In Re William Adler and Co Ltd [1935] Ch 138. The facts of the case from the headnote were that "A company passed a resolution for voluntary winding up. Five days later a petition was presented by a creditor for a compulsory order, and a month later the usual compulsory order with the usual order as to costs was made. The voluntary liquidator appeared on the petition in opposition to it. On the taxation of costs the registrar disallowed certain items of costs incurred by the liquidator after the resolution but before the petition was heard, including the costs of consultations by the liquidator and of obtaining council's opinion. The solicitor to the liquidator then brought in a further bill of costs, including items disallowed on the previous taxation, but allowable on a taxation between solicitor and client. The Court held that other costs incurred by the voluntary liquidator between the date of the resolution to wind up the company voluntarily and the order made on the petition for compulsory winding up were "Fees and expenses incurred in preparing the assets".

¹⁰⁴ In Re Circuit Developments Ltd (In Liquidation) Ex Parte Mortimer [1981] 2NZLR, 273 "The applicant represented members of" Circuit House Syndicate". The syndicate owned a commercial building which was leased to Circuit Developments Ltd ("The Company"). The company went into voluntary liquidation on 7/10/74. It was not until 20/5/75 that the liquidator effectively surrendered the lease. Between the time that the company went into voluntary liquidation and the date of disclaimer, arrears of rent accrued to the amount of approximately \$10,000. In 1976 the applicant sought an order that the amount was an expense incurred in the winding up and payable to the syndicate pursuant to section 299. Those proceedings were successful and Mahon J made the order sought.

In these proceedings the applicant sought leave to proceed by way of attachment, distress or execution against the estate or assets of the company pursuant to section 273(b).

See also Re Downer Enterprises Ltd [1974] 2A11ER 1074 (Chancery Division).

accountants fees¹⁰⁵. Costs awarded against the liquidator have also been considered to be costs of the liquidation, although the courts have held that they are to be paid in priority to the ordinary costs of the liquidation¹⁰⁶.

Income Tax incurred after liquidation, however, has been held not to constitute a fee or expense "... incurred in realising or getting in the assets", although it was held Sections 261 and 293 provide that costs charges and expenses of applicants are to be paid out of assets. Under Rule 168 fees and expenses are payable if they can be regarded as having been properly incurred "in preserving, realising or getting in the assets".

Amounts available for distribution

It seems to be clearly established from case law that the assets referred to are "free assets" and that that does not include assets which are subject to a fixed charge but

¹⁰⁵ Re Barleycorn Enterprises Ltd [1970] 2A11ER 155.

In summary, Accountants prepared a statement of affairs at the request of the Directors of Barleycorn. Fees of £202.10s were approved by the Official Receiver. While the main issue of the case related to priority to be given to preferential claims vis a vis floating charges under a debenture the court also determined that the accountants' fees were a cost of winding up.

¹⁰⁶ The costs are also to be paid in priority to the remuneration of the liquidator - see Re London Metallurgical Co [1895] 1 Ch 758 In summary - company wound up; a the liquidator placed Parker on the list of contributories and he took out a summons to have his name removed from the list; an order was made for the removal of Parker's name from the list and directing liquidator to pay taxed costs of application out of the assets of the company; Liquidator refused, for a number of reasons to accede to the demand immediately and Parker obtained a summons for immediate payment.

See also Re Pacific Coast Syndicate Ltd [1913] 2Ch 26; In re Wilson Lovatt and Sons Ltd [1977] 1A11ER 274 for restatement of principles.

to be an expense of winding up¹⁰⁷.

What constitutes "assets" of the company for the purposes of Sections 261, 299 and Rule 168

The issue of what are the "assets" referred to in Sections 261, 299 and Rule 168 is important in so far as that determines what amounts are available for distribution. Sections 261 and 299 provide that costs charges and expenses of applicants are to be paid out of assets. Under Rule 168 fees and expenses are payable if they can be regarded as having been properly incurred "in preserving, realising or getting in the assets".

"Amounts" available for distribution

It seems to be clearly established from case law that the assets referred to are "free assets", and that that does not include assets which are subject to a fixed charge but does include assets subject to a floating charge at the time of liquidation. That this is the situation is seen from the following decisions:-

. Re J. G. Ward Farmers' Assn (1898) 16NZLR 322

¹⁰⁷ In Re Beni Felkai Mining Co Ltd [1934] Ch 406.

The relevant facts were that the Company owned and worked mines Algeria; December 1925 court sanctioned scheme for transfer to 2 French Companies of whole of company's assets; Company's manager was appointed liquidator and creditors told that liquidation formal and they would be paid in full; from June 1928 liquidator could preserve assets only by borrowing and by means of an overdraft from the Company's bank; In 1929 and 1930 various tax assessments were made; before last assessment received Company's mine had closed and French Companies had gone into liquidation; included in the disbursements made by the company were sums retained by liquidator as remuneration and for travelling expenses.

It was considered that the profits arising from the working of leasehold premises charged by debentures and remaining in the possession of the mortgagor were free assets in the hands of the liquidator. The court decided that it had no jurisdiction to direct a liquidator to apply the proceeds of property subject to a security to the general costs of the liquidator¹⁰⁸.

Re Barleycorn Enterprises Ltd [1970] 2ALLER 155.

In that case preferential claims for rates and wages were £5,161 and exceeded the assets of the company of £4,744. There was a floating charge under a debenture on the whole of the company's assets. In the course of reaching his conclusion that "assets" included property subject to a floating charge Lord Denning MR explained how the term "asset" had acquired a new meaning since the equivalent of Section 308(4) of the Companies Act 1955 was inserted into the United Kingdom legislation¹⁰⁹, that the legislature no longer regarded property subject to a floating charge as belonging wholly to a debentureholder on winding up and that such property was part of the assets of the company applicable first in payment of costs and expenses of winding up, second in payment of preferential claims and only thirdly in payment of the debentureholder.

¹⁰⁸ Re Willis C Raymond Ltd [1928] NZLR 115 confirmed that "assets" meant "free assets" and held that only the liquidator's costs of the realisation of the secured property would take priority to the secured creditors; that a liquidator's remuneration must come out of free assets.

¹⁰⁹ Page 158 of the decision, He referred to Mr Topham's book on Company Law confirming his view.

What fees and expenses are met where an asset subject to a security is realised?

The case law appears to establish that the liquidator's costs, charges and expenses associated with the realisation (and by implication also fees/Official Assignee's commission) are a "first charge on the assets. It has been held, however, that other general costs of winding up, such as liquidator's remuneration, will only be payable if there is a surplus after the principal and interest of the holders of the charge have been met e.g.,

- . In Re Northern Milling Co [1908] 1 1R 473 held that in such circumstances "the liquidator's costs, charges and expenses of realisation rank first; the principal and interest of the holders of the charge next and general costs of winding up are paid out of the surplus if any"¹¹⁰.
- . Re Willis C Raymond Ltd [1928] NZLR 115 held that assets meant "free assets" and that only the liquidator's costs of the realisation of the secured property would take priority to the secured creditors, that liquidator's remuneration had to come out of the free assets¹¹¹.
- . Caxton Products Ltd v The Packaging House Ltd

¹¹⁰ See also Re Regents' Canal Ironworks (1976) 3ChD 411.

In Re JG Ward Farmers Assn (1898) 16NZLR 322 it was held that the Court had no jurisdiction to direct a liquidator to apply proceeds of property which was subject to a security to the general costs of the liquidation. If more expense than was necessary to realise the security was incurred then it had to be borne by the liquidator.

¹¹¹ Referred to in Anderson's, Company and Securities Law, p 1-494.

(unreported decision High Court Auckland April 1990 M 142/90)

The issue that arose was whether r 700w of the High Court Rules gave the court the jurisdiction to order that costs awarded to the plaintiff in an application, heard at the same time a provisional liquidator was appointed, could be paid in priority to the claims of secured creditors. Smellie J, relying amongst other things, on the decisions of Re JG Ward Farmers Association (Limited) supra and Re Willis C Raymond Ltd (In liquidation) concluded that r 700W did not give the court such jurisdiction to reduce what would otherwise be available to the secured creditors.

Re Your Size Fashions Ltd (1990) 5NZCLC 66,804
the facts, from the headnote, were:-

"Your Size Fashions Ltd ("the company") was wound up on the petition of a creditor. The Official Assignee became the Official Liquidator of the company and took possession of the company premises. Westpac Banking Corporation ("Westpac") held a first ranking debenture over the undertaking of the company. It was the policy of the Official Assignee not to take any action in respect of the realisation of the assets of a company where he formed the view that there was no realistic possibility of any funds being available for unsecured creditors after the satisfaction of secured creditors and granted an indemnity by the secured creditors.

Pursuant to this policy the Official Liquidator ("the liquidator") was not prepared to take any action in respect of the realisation of the assets of the company. The liquidator notified Westpac of this and sent keys to the company's premises to Westpac which Westpac duly returned to the liquidator. Westpac declined to appoint a receiver under its debenture as the cost of a receivership would have exceeded the value of any realisation after payment of preferential creditors.

In view of the dispute the matter was referred to the Court for resolution. The liquidator sought a direction as to whether it was bound to realise the assets of the company".

Williamson J held that the Official Assignee was obliged to act and was not entitled to require appointment as a secured creditor's agent, nor entitled to call upon secured creditors to indemnify him. His honour implicitly accepted that the Official Assignee was entitled to commission pursuant to the Companies (Winding Up) Fees Regulations 1984 and to expenses related to the realisation of the asset. While there was no comment on where the Official Assignee's commission or expenses would rank it seems on the basis of the earlier decisions of Re

Clause 4 of the schedule to the Companies (Winding Up) Fees Regulations 1984 makes it clear that a fee is to be paid, although it does not refer to order of payment. The fact that clause 4 specifically refers to the Official Assignee being appointed agent of the debenture holder could also bring the whole of the Journalis decision into question.

[1988] 1 IR 473

Willis C Raymond Ltd¹¹² and Re Northern Milling Co¹¹³ that they would rank first.

When, in comparison to expenses, should a liquidator's remuneration be paid?

While it appears arguable, on the basis of the statutory provisions alone, that by virtue of Rule 168 all expenses of a voluntary winding up ought to be paid before the remuneration of the liquidator this position is not sustainable on the basis of the decision of Re Beni Felkai

¹¹² [1928] NZLR115. It was only stated that remuneration had to come out of the Free assets, not fees.

That it was acceptable in Re Yoursize Fashions Ltd (1990) 5NZCLC 66,804 that commission should be payable is evident from Williamson J's comments at pp 66-806 and 66,806 i.e.,

. "Apart from resolving theoretical matters of principle, the proceedings appear to have been motivated by the fact that the commission payable to Official liquidators is significantly lower than the current level of receiver's fees" (page 66,806)

. "... It is hardly surprising that the Official Assignee would consider that there are good reasons why the control and initiatives in relation to realisation should be taken by the creditor, especially if the rates of commission payable to the liquidator are insufficient to meet the actual costs to the crown of providing an official liquidator" (page 66,812)

It is noted that the official liquidator claimed the commission as a further expense rather than a fee at page 66,808.

Clause 4 of the schedule to the Companies (winding up) Fees Regulations 1984 makes it clear that a fee is to be paid, although it does not refer to order of payment. The fact that clause 4 specifically refers to the Official Assignee being appointed agent of the debenture holder could also bring the whole of the Yoursize decision into question.

¹¹³ [1908] 1 IR 473.

Mining Company Ltd¹¹⁴. In that decision the court held that the equivalent provision to Section 261 relating to compulsory winding up was also available in a voluntary winding up situation by virtue of the equivalent section to Section 298 of the Companies Act 1955. In these circumstances any liquidator, contributory or creditor in a voluntary winding up could also apply to the court and the court could exercise its discretion as to payment of "costs, charges and expenses" (including liquidator's remuneration) in such order of priority as it thinks just"

While the court commented that prima facie expenses ought to be paid before liquidator's remuneration it considered that in a proper case a court could "authorise a liquidator to keep remuneration which he retained when he had no reason to believe that a company's assets would not be sufficient to discharge all costs, charges and expenses of the liquidation"¹¹⁵.

The decision of Re Beni Felkai Mining Co Ltd¹¹⁶ has been directly applied in New Zealand by Prichard J in Re Circuit Developments Ltd (In liquidation)¹¹⁷. While the prime issue arising in that case was whether rent accrued

¹¹⁴ [1934] ch 406.

¹¹⁵ Above n114, P 406 It was held in that case that the liquidator should be authorised to retain specified remuneration; Anderson's, Company and Securities Law, paragraph 299-05 concludes that Maughan J's judgment in Re Beni Felkai Mining Co Ltd is applicable in New Zealand i.e., that the court may "by exercising under section 298 the power given by section 261 order payment of remuneration in priority to other costs, charges and expenses incurred in the winding up". See also In Re London Metallurgical Co [1895] 1 Ch 758 reference was made to the liquidator's remuneration being subject to r 168 of the winding up rules.

¹¹⁶ Above n115.

¹¹⁷ [1981] 2NZLR, 243.

by a liquidator was an expense the court also commented on the fact that prima facie the whole of the expenses of the winding up ought to be paid before the remuneration of the liquidator¹¹⁸.

The meaning to be given to terms used in Section 308

As indicated at page 39 above most of the litigation concerning Section 308 has centred on terminology used in subsections (1)(a) and (b) although significant issues have also arisen in respect of money advanced for wages, salary and holiday pay pursuant to subsection (3) and concerning the priority to be given to PAYE and Sales Tax¹¹⁹. (Given that Sales Tax has been largely superseded

¹¹⁸ The court went on to comment that "If his position is that, having provided for them, there is no remuneration left for him he is entitled to ask creditors or shareholders to put up a fund for his benefit". Page 243.

¹¹⁹ Obviously other issues have also been considered by the courts but the aim of this Chapter is to highlight the most significant areas of litigation. Anderson's, Company and Securities Law pp 547 to 551 and New Zealand Company Law and Practice (Commerce Clearing House) provide a detailed overview of other areas covered e.g., decisions relating to the meaning of "any other person" in subsection (6), is not intended to be discussed in the paper. The case law dispute as to relative priority of Sales Tax is of interest in so far as it serves to highlight problems which can result from a priority being created via "outside legislation" rather than being self contained in the Act itself. See, for example, Bank of New South Wales v Collector of Sales Tax [1974] 1NZLR 322 and Re Arnold Trading Co Ltd [1983] NZLR 445 (Court of Appeal which distinguished Bank of New South Wales (supra)). In Re Burney's Glass Co Ltd (In liquidation) [1938] NZLR 92 (which distinguished Bank of New South Wales (supra)). See also Re Westmoreland Box Company Ltd (in liquidation), Crawshaw v Commissioner of Inland Revenue [1968] NZLR 826 for discussion of relative priority of PAYE tax. Amongst other things the Court of Appeal held that the Income Tax Act provisions made it clear that unpaid PAYE tax deductions were not covered by section 308 (1)(d) of the Companies Act 1955.

by GST and the provisions relating to PAYE tax priorities have been amended since the relevant case law it is not proposed to discuss these matters further).

Section 308 (1)(a) and (b)

Specific issues arising in respect of subsections (1)(a) and (b) have included when the 4 months period for which wages or salary can be claimed is payable where a voluntary winding up has been succeeded by a compulsory winding up¹²⁰; whether or not living or other expenses are included within salary or wages¹²¹; and whether or not someone is employed as a "servant" as opposed to, for example, being an independent contractor. In the latter case the voluminous law which is relevant to the law of employment generally is applicable¹²².

Section 308 (3)

The rationale behind Section 308 (3) was clearly explained

¹²⁰ Re Havana Exploration Co Nathan's claim [1916] 1Ch 8 held that the relevant period was 4 months before the resolution to wind up.

¹²¹ Re R McGaffin Ltd, Ex p Lord [1938] NZLR 764 Held that where living or other expenses were paid as part of a "servant's" "pay package" then such expenses were entitled to rank under 308 (1)(a).

¹²² Anderson's Company and Securities Law refers to a large number of cases, including the decisions of Performing Rights Society v Mitchell and Booker Ltd [1924] 1KB 762 and Lee v Lee's Air Farming Ltd [1961] NZLR 325 which refer to the general tests to be applied in deciding whether or not a person is a servant.

in Waikato Savings Bank v Andrews Furniture Ltd¹²³. In reaching his conclusion that the moneys transferred by the savings bank to individual employees for the purposes of paying their wages were moneys "advanced", and that "advanced" covered a payment other than a loan Prichard J commented that:-

"The rationale of the provision is that if the wages of an employee of a company are paid out of funds provided by someone other than the company - thereby reducing or eliminating the priority claims which the employee would otherwise have on a winding up - then the person who provided those funds is entitled in a winding up to stand in the shoes of the employee as regards priority over all other creditors"¹²⁴.

In the case of Re Symphonia of Auckland Foundation (Inc) (In Liquidation) (1983) 1NZCLC 98,750 the High Court addressed, amongst other things, the issue of how Section 308(3) operated where less than the full amount allowable

¹²³ (1982) 1NZCLC 95,064. The facts of that case were, from the headnote, that a "Bank operated a payroll scheme whereby it established savings accounts for individual employees of a company. Each pay day the bank transferred to the account of each employee the amount due for wages. Funds were supplied for the purpose by the company. In January and February 1980 three cheques from the company meant to cover wages were dishonoured after wages had already been transferred to the employees' accounts by the bank"

¹²⁴ Page 95,065. In the subsequent decision of Re Symphonia of Auckland Foundation (Inc) (In liquidation) (1983) 1NZCLC 98,750 Wallace J commented at page 98,756 that ". . . . despite the lengthy period during which section 308 has been on the statute books both in this country and in the United Kingdom. . . ." there was no relevant authority apart from Waikato Savings Bank v Andrew Furniture (in receivership) (supra) which did not cover the matters at issue in this case.

as a preference (at that time \$1,500) had been advanced¹²⁵. The facts of the case were that¹²⁶:-

"the arts council had provided sufficient funds to enable the liquidator to pay the outstanding wages of all but three employees. Those three employees received \$34,895.13, which was some 60% of the wages due to them. Counsel for the liquidator submitted that the arts council is entitled to have priority to the extent of \$1,500 (or such lesser sum as has been paid) [counsel] - for the three employees contended that - the three employees who have not been paid in full remain entitled to a priority payment of \$1,500 and that the arts council is not subrogated to their right to that payment even though the arts council advanced 60% of their wages (in each case exceeding \$1,500)".

Wallace J concluded that the Council did not have a right of priority where the three workers had not been paid in full:-

"Those servants or workers, who are allowed more than \$1,500 of wages or salary in respect of services rendered in the relevant four month period, remain entitled to be paid in priority the sum of \$1,500

¹²⁵ In that case the Symphonia of Auckland Foundation (Inc) was voluntarily wound up at a special general meeting of the members of the Queen Elizabeth II Arts Council. The liquidator applied for directions on a number of points including the issue of "If section 308 applies, what rights of priority does the arts council who provided funds to enable the liquidator to pay the outstanding wages of all but three employees of the Society, have as a creditor".

¹²⁶ Page 98,755

each in terms of Section 308(1)(a)"¹²⁷.

Other issues relating to Section 308(3) have included whether or not a redundancy agreement advance was covered¹²⁸ and whether or not payments of wages from an overdraft account enabled a bank to claim a priority¹²⁹.

(ii) Case Law in the United Kingdom.

As indicated by the numerous references to United Kingdom case law in the discussion above regarding New Zealand decisions there is a great deal of overlap in "focus areas" of the two jurisdictions¹³⁰ e.g., what constitutes

¹²⁷ Page 98,756.

The rationale for this conclusion was set out at p 98,756 in the following terms:-

- . ".... so long as \$1,500 remains owing to a servant in respect of services rendered during the relevant four month period specified by Section 308(1)(a), payment by a third party cannot be said to have diminished the servant's priority".
- . ".... As the Section is worded, it appears to me that it must be the sum of \$1,500 (rather than the total sum owing to the servant) which is "the sum in respect of which the servant would have been entitled to priority".

Once, however, there is less than \$1,500 owing the servants' priority is diminished e.g., if a servant is owed \$2,000 and a third party pays \$1,000, then the servant is entitled to priority for \$1,000 and the third party for \$500".

¹²⁸ Re Andrew M Paterson Ltd [1981] 2NZLR 289 held that a redundancy agreement was compensation and not wages.

¹²⁹ Re Primrose (Builders) Ltd [1950] Ch 561. See Anderson's, Company and Securities Law, p 549 for reference to further case law and discussion.

¹³⁰ Case law relating to legislation prior to the Insolvency Act 1986 still remains relevant in some instances.

a cost charge or expense of winding up?, what constitutes "assets" of the company? whether or not specific funds constitute advances for payment of wages¹³¹. In addition there has been a significant quantity of case law in the "intricate" areas of the tax related provisions¹³² and in determining whether or not payments constitute wages and salaries, whether or not an individual is a "servant".¹³³

and what assets are available to meet preferential payments arise in the Australian context despite slight differences in terminology. Similarly, while the New Zealand legislation only provides a preference for advances by a third party on account of wages, salary or holiday pay (whereas the Australian provisions extend to leave of absence and retrenchment payments),¹³⁴ similar issues have arisen as to whether or not the payment was made out of money advanced for such a purpose.¹³⁵

Issues arising where the statutory provisions are significantly different from those in New Zealand have included the following - whether the Tax Commissioner can show that property of the company is under the "control" of a liquidator so that unremitted tax is payable to the

¹³⁴ e.g., Re Nicholls Pty Ltd (1982) 1ACLC 408 costs incurred by a liquidator in an application for an order staying winding up may if the court directs be

¹³¹ e.g., Re Rampgill Mill Ltd [1967] ch 1138; Re James R Rutherford and Sons Ltd [1964] 1WLR 1211; Re William Hall (Contractors) Ltd [1967] 1WLR 948

¹³² See Palmer's, Company Law, page 15,170 for a general discussion e.g., Re Pratt [1951] ch 255. It was held that the Crown's priority to tax was not limited to tax assessed in the year immediately before the winding up, that it could claim priority for any one year before that date. Food Controller v Cork [1923] AC 647 (HL) Held that each tax could be claimed for separately.

¹³³ e.g., Re VIP Insurance Ltd and Cos Act [1978] 3ALLER, 3 and Re Leeds Twentieth Century Distributors (1962) CLY 365 (referred to at pp 15171 - 15172 Palmer's Company Law).

(iii) Case Law in Australia

As is the situation with the United Kingdom provisions the similarities between some of the Australian and New Zealand provisions means that the same case law is applicable in both jurisdictions. Again issues of what constitute "costs, charges and expenses", of a winding up and what assets are available to meet preferential payments arise in the Australian context despite slight differences in terminology.¹³⁴ Similarly, while the New Zealand legislation only provides a preference for advances by a third party on account of wages, salary or holiday pay (whereas the Australian provisions extend to leave of absence and retrenchment payments),¹³⁵ similar issues have arisen as to whether or not the payment was made out of money advanced for such a purpose.¹³⁶

Issues arising where the statutory provisions are significantly different from those in New Zealand have included the following - whether the Tax Commissioner can show that property of the company is under the "control" of a liquidator so that unremitted tax is payable to the

¹³⁴ e.g., Re Nicholls Pty Ltd (1982) 1ACLC 408 costs incurred by a liquidator in an application for an order staying winding up may if the court directs be part of the costs, charges and expenses of the liquidator; decisions of Re Securitibank Ltd (1978) 1NZLR 97 (cost of seeking directions are a cost or expense) In re London Metallurgical Co (1895) 1 ch 758 and Re Barleycorn Enterprises Ltd; Mathias and Davies (affirm) v Dan (Liquidator) (1970) 2ALL ER 155 (Assets available to meet preferential payments are "free assets")

¹³⁵ and ss 560 and 561 provide that such advances will be given a priority over floating charge holders.

¹³⁶ United Kingdom case law has been held to be directly applicable e.g., Company Law and Practice (C.C.H.) p 244, 391. For example Re Primrose (Builders) Ltd (1950) 2ALL ER 334, Re EJ Movel (1934) Ltd (1961) 1ALL ER 796 and Re James R Rutherford and Sons Ltd (1964) 3ALL ER 137 have been held to be directly applicable.

Commissioner in terms of Section 221P of the Income Tax Assessment Act 1936 (PAYE deductions)¹³⁷; whether a liquidator's costs are always payable before those of a provisional liquidator¹³⁸; whether payments are costs, charges and expenses of official management or debts of the company incurred by the official manager which justify being given a preference in terms of Section 556(1)(c) or 556(1)(d)¹³⁹; whether or not a payment constitutes a retrenchment payment¹⁴⁰.

(iv) Case Law in the United States

It is not intended, even if it were possible in an overview paper of this nature, to give any detailed consideration to the relevant United States case law. Rather, the intention is to indicate areas/matters which might need to be borne in mind if future reformers decide to draw on the United States model¹⁴¹.

¹³⁷ e.g., DFC of T v AGC (Advanced) Ltd and Ors 84ATC 4776; Holloway Transport Pty Ltd 83 ATC 4164; Re Mzimba Pty Ltd (1989) 7AACL 464.

¹³⁸ Shirlaw v Taylor (1991) 9 ACLC 1,235 held that where a provisional liquidator had an equitable lien for payment of costs, expenses and remuneration then a priority was not given to the liquidator's costs and expenses.

¹³⁹ See for example Re Jovien Investments Pty Ltd (1982) 1AACL 474.

¹⁴⁰ Section 556(2) defines the payments as "an amount payable by a company to an employee by virtue of an industrial instrument". International Harvester Export Company v International Harvester Australia Limited (1982) 1AACL 580 considered whether a specified payment was a redundancy payment.

¹⁴¹ e.g., the fact that the United States case law in this area is voluminous may indicate the need for amended provisions in that jurisdiction, that those provisions/some of those provisions should not be followed/adopted in New Zealand. It is not of course possible to reach definite conclusions as to the reasons for the extent of the case law.

Whereas cases in New Zealand have concentrated on a few specific areas United States case law appears to cover the range of matters (including general issues such as whether or not priority provisions should be construed strictly or broadly¹⁴²) with there being greater emphasis on some areas¹⁴³. To some degree the extent of coverage is evidenced by the range of "topic headings/categories in the case notes and the subsections of these categories"¹⁴⁴.

While the subsections within the categories are too extensive to refer to individually it is interesting to note that in the case of "Administrative" expenses and Section 507 priority for "wages, salaries or commissions" similar types of issues, as have arisen in New Zealand appear. For example, in the case of "Administrative" expenses - whether attorney's fees should be paid and in what circumstances? whether specified items constitute costs and expenses of preserving assets? Whether/what priority should be given to rent payments?

Cases considering whether or not administrative costs have been "actual, necessary costs and expenses" of administration¹⁴⁵ have found for example, that:-

- . a compensatory fine for violation of an injunction imposed upon a debtor while engaged

¹⁴² It has been held that they should be construed strictly. See United States Code Annotated (Title 11 Bankruptcy) ss 501 to 543 1992 supplementary pamphlet for reference to cases.

¹⁴³ e.g., tax claims generally and specifically have been the subject of a great deal of litigation.

¹⁴⁴ There are nine subcategories of cases - General, Law Governing secured claims, administrative expenses, wages, salaries or commissions, tax claims - generally, tax claims - particular tax claims and tax claims - particular assessments constituting taxes.

¹⁴⁵ Section 503.

in a Chapter 11 reorganisation was an actual and necessary expense although the injunction arose from nuisance rather than negligence proceedings.¹⁴⁶

post petition expenditure by a property owners association for "insurance, utilities, cable, fire alarm monitors, landscape maintenance and taxes" in a Chapter 11 case qualified although "post petition expenditures for supplies, printing, architectural review, legal and audit, other professional services, contingencies, bad debts expenses and management fees" did not.¹⁴⁷

Compensation for actual and necessary expenses has been

¹⁴⁶ In re Charlesbank Laundry Inc CAI (Mass) 1985, 755 F2d 200 referred to in United States Code Annotated (Title 11 Bankruptcy) ss 501 to 543, 1992 supplementary pamphlet p 40.

¹⁴⁷ Above n146, p 42 also refers to In re Packard Properties Ltd Bankruptcy ND Tex 1990 118 BR 61 and Jack Winter Apparel Inc EOWIS (1990) 119 BR 629:-

"among the factors to be considered in determining whether a claimant has made a substantial contribution to reorganisation, and thus whether an attorney fee claim has status as an administrative expense, are whether services were rendered solely to benefit a client or to benefit all parties to a case; whether services provided direct, significant and demonstrable benefit to an estate"

See also In re Buttes Gas and Oil Co, Bankruptcy SD Tex 1989 112 BR 191 referred to at page 43 of the supplementary pamphlet:-

"In order for an administrative expense claimant to have made substantial contribution to Chapter 11 reorganisation, and thus be entitled to payment of expenses from an estate, a contribution must provide tangible benefits to bankruptcy estate and other unsecured creditors, incidental benefit to an estate standing alone, is not a sufficient basis for administrative status."

paid to attorneys, accountants and indenture trustees as an administrative expense when they have succeeded in uncovering undisclosed assets¹⁴⁸ or, while not recovering assets, have fulfilled duties¹⁴⁹. So far as the Section 507 priority for unsecured claims for "wages, salary or commissions, including vacation, severance and sick leave pay" is concerned issues have included what category did severance pay fit into? whether employee contributions to medical and health insurance constitute "wages", what priority should be given to vacation pay? were the workers

¹⁴⁸ Also note there has been considerable recent case law where such payments have not been made, generally because time has been spent by creditor's counsel and did not benefit the estate as a whole e.g., In re Stoecker, Bankruptcy ND 111 1991, 128 BR 205 and In re Mishkin, Bankruptcy SDNY 1988, 85 BR 18 referred to in United States Code Annotated (Title 11 Bankruptcy) ss 501 to 543 1992 supplementary pamphlet p 45.

¹⁴⁹ Above n148 p 47 reference is made to In re Anton Bankruptcy SD Fla 1990, 122 BR 788.

In referring to the duties of a trustee, his counsel and accountants commented "while success in their reorganisation endeavour is a factor to be considered in awarding compensation, lack of success does not necessarily bar compensation". See also the reference to In re Jensen - Forley Pictures Inc Bankruptcy Utah 1985, 47 BR 557 at p 47 of the supplementary pamphlet.

employees?¹⁵⁰

The fact that similar issues arise in the United States could be an indication that the adoption of that system, or any priority system, will provide bases for argument - whether outside or inside court¹⁵¹. This view is endorsed by the prolific tax law¹⁵². While tax and excise "priorities" cases have covered the range of Section 507(6) matters particularly prominent issues have included whether taxes are covered by the Section 527 priorities or administrative expenses which should be dealt with under

¹⁵⁰ Above n146, p 109 refers to "re Packer Ave Associates, Bankruptcy Pa 1979, 1 BR 286 (a proceeding under former section 801) which discussed the elements necessary for such a claim. It was commented that, amongst other things, such payments must have been "earned by workmen, servants, clerks or travelling or city salesmen".

The main issue which has arisen in respect of severance payments has been whether or not a sum in fact constitutes a severance payment or an administrative expense. It has been established that "pay at termination in lieu of notice is considered an administrative expense but pay based upon length of employment is not, because the latter is actually a form of remuneration for work performed before the filing date". (The cases of Pacific Far East Line Inc CA Cal 1983, 713 F2d 476; Matter of Health Maintenance Foundation, CA Cal 1982, 680 F2d 619 are discussed at page 109 of the supplementary pamphlet).

¹⁵¹ Which could have a negative economic effect. While this in itself may not be a reason for dispensing with priorities it may indicate an issue to be addressed in assessing the "efficiencies" of a priorities regime, from an economic or other point of view.

¹⁵² Above n146, p 110 refers to In re International Automated Machines, Bankruptcy Ohio 1981 13 BR 119 s 507(4) unsecured claims for contributions to employees plans were considered in that case. It was held that the priority was limited to claims for contributions to employee benefit plans such as pension plans, health or life insurance plans and others arising within the specified periods.

Section 503(b)¹⁵³; whether amounts are penalties¹⁵⁴; whether penalties are "pecuniary" or "punitive"¹⁵⁵; whether they are non-dischargeable debts¹⁵⁶.

In addition to Section 507(a)(6) tax related matters issues relating to tax liens, including those discussed at pages thirtyone to thirtyfour above have been numerous.

¹⁵³ Above n146, p 116 refers to Re Duby, Bankruptcy DRI 1989, 98 BR 126. Capital gains taxes incurred upon sale of estate property are obligations incurred by the estate and constitute administrative expenses which have first priority status.

Reference is also made at the same page of the supplementary pamphlet to In re Higgins Bankruptcy Iowa (1983) 29 BR 196 page 116. A claim by Internal Revenue Service for investment credit recaptured tax was not entitled to priority as an administrative expense since such tax was an income tax specified in the section which provides certain priority to government or secured tax claims and investment credit recaptured tax related back to debtors' pre bankruptcy evaluating not to administration and distribution of the estate assets. Thus such tax was not a tax incurred by the estate.

¹⁵⁴ Above n146, p 119 refers to Re Mansfield Tire and Rubber Co CA6 (Ohio) 1991, 942 F2d 1055 "Federal pension excise tax resulting from debtors' failure to meet minimum funding requirements for a pension plan was "excise tax" entitled to priority, rather than a non priority "penalty".

¹⁵⁵ "pecuniary" penalties qualify for priority whereas "punitive" ones do not.

See for example above n146, p 116 for reference to - In re CT of Virginia, Inc; Bankruptcy WD Va 1991, 128 BR 628; In re Divine, Bankruptcy D Minn 1991, 127 BR 625.

¹⁵⁶ section 523 refers to exceptions to discharge which in turn refers to section 507(a)(3)(B)(C) and (6) as being debts excepted from discharge. See, for example, above n146, p 119 for reference to In re King Bankruptcy WD Tenn 1990, 117 BR 339 Retail Sales taxes in Tennessee qualify as "trust fund taxes" and thus debtors' tax obligation was non dischargeable regardless of time of its assessment or due date.

V Statutory Preferences in Receiverships, Formal and Informal Arrangements and Statutory Management regimes in New Zealand : Operation of preferences and issues raised in respect of preferences where a company is in liquidation.

(i) The Operation of Preferences in Receiverships : Comparison and interrelationship with preferences in liquidations.

Applicable statutory provisions and relevant time limits vary according to whether a receiver is appointed prior to liquidation.

While the preferences which apply in a receivership are the same as those in a liquidation the applicable statutory provisions and time limits vary according to whether a receiver is appointed prior to a liquidation. Section 101 of the Companies Act establishes the priority of Section 308 preferential debts over a floating charge¹⁵⁷ when a receiver is appointed before the passing of a winding up order is made¹⁵⁸. If, after the appointment of a receiver, a winding up order is subsequently made then Section 101 still provides the bases for preferential debts¹⁵⁹. Consequently the time

¹⁵⁷ Section 101(6) defines floating charge as in s 308 "includes a charge that conferred a floating security at the time of its creation but has since become a fixed or specific charge".

¹⁵⁸ See Peter Blanchard, *The Law of Company Receiverships in New Zealand* pp. 80-81 for general discussion.

At p 80 he makes the point that a company is not "in the course of being wound up" because a winding up petition has been presented before the receivership commences.

¹⁵⁹ Bank of New South Wales v Federal Commissioner of Taxation (1979) 28ALR 43 referred to in Blanchard, *The Law of Company Receiverships in New Zealand*, p 81.

periods referred to in Section 308 start from the date of the appointment of the receiver rather than the date of the appointment of a provisional liquidator or winding up order¹⁶⁰.

If a receiver is appointed after a Company has gone into liquidation¹⁶¹ then Section 308 applies, Section 101 has no relevance and the applicable time limits do not run from the date of the appointment of the receiver but rather the "relevant date" defined in Section 308(7). As in the Section 101 case the preferential unsecured debts, by virtue of Section 308(4)(b), have priority over floating charge holders where the company's assets are insufficient to meet the debts of unsecured creditors.

Receivers Costs and expenses relative to preferential creditors

While Sections 101 and 308 of the Companies Act cover priorities between unsecured creditors and floating charge holders there is no provision relating to claims of receivers and preferential creditors. While there are no statutory provisions allowing for costs and expenses of receivers¹⁶² it seems to be generally accepted, that on the basis of case law, a receiver's costs and expenses rank ahead of statutory preferential claims but after the costs and expenses of any liquidator in preserving and

¹⁶⁰ See definition of relevant date in s 308(7). Also refers to voluntary winding up.

¹⁶¹ whether voluntary or by court order.

¹⁶² No equivalent to ss 261, 299 and r 168 dealing with liquidator's costs and expenses.

realising assets¹⁶³.

(ii) The operation of statutory preferences in liquidations/moratoriums: How can arrangements affect statutory preferences when a company is in liquidation?

Prior to liquidation compromises and arrangements can be reached informally, in which case it is necessary that creditors concerned unanimously agree, or formally (via Section 205 of the Companies Act, in which case 75% creditor approval of the scheme and court sanction is required). As discussed by Farrar and Russell¹⁶⁴:-

"The procedure begins by an application to the court to order a meeting of creditors or class of creditors to be held to consider the proposal. It will be approved by the creditors if a majority in number representing three-fourths in volume of the creditors or class of creditors, as the case may be, present and voting either in person or by proxy at the meeting agree with the proposal. The company then returns to court and if the court sanctions the proposal it becomes binding on all the creditors or class of creditors as the case may be. The protection for dissenting creditors is in the need for the courts' sanction when creditor's objections can be considered".

After liquidation the liquidator can still make application to the court, in terms of Section 205, to have

¹⁶³ see Blanchard, *The Law of Company Receiverships in New Zealand*, pp 93-94 Bank of New South Wales v Federal Commissioner of Taxation (1979) 28ALR 43 and Farrar and Russell *Company Law and Securities Regulation*, p 430.

¹⁶⁴ *Company Law and Securities Regulation* p 444.

a scheme sanctioned and while the position regarding informal schemes is less "clear cut" arrangements appear to be able to be made¹⁶⁵. So far as Companies that are in liquidation and preferred creditors are concerned issues of importance relating to schemes of arrangement include the following:-

- (i) schemes that existed prior to liquidation can still apply after liquidation. This can raise general issues of unfair preference as well as making it difficult to establish exactly who is to be preferred e.g.,
- . general unsecured creditors who reached an agreement 3 months prior to liquidation could be advantaged over those becoming creditors during the subsequent 3 month period.
 - . if creditors agree to a moratorium of debts for 12 months and agree to give priority to current creditors but the company goes into liquidation during the 12 months then current creditors will rank ahead of the creditors who agreed to the moratorium.
- "But if the company goes into liquidation after 15 months, but those who became become creditors during the 12 month moratorium are still unpaid do the latter

¹⁶⁵ i.e., it has been argued that an agreement to give up rights is not binding because it is contrary to the pari passu principle - Re Walker Construction Co. Ltd [1960] NZLR 523. There is a lot of argument to the contrary however in the United Kingdom, Australia and New Zealand. See for example Farrar and Russell Company Law and Securities Regulation p 445.

group still have priority?"¹⁶⁶

where the arrangement is partially completed prior to liquidation does it take precedence over preferred creditors after the company goes into liquidation?

- (ii) Irrespective of whether one considers preferences are desirable or not the reality is that schemes can be adopted which are contrary to the statutory preference scheme (the fact that preferences do not have to be taken into account in such schemes however reduces any suggestion that there are "unquestionable philosophical bases" for preferences in other situations) e.g.,

the fact that only 75% creditor approval for a court sanctioned scheme is required means that some existing preferential creditors (bar the crown¹⁶⁷) could, in relative terms, be disadvantaged.

it also appears that some future preferential, as well as ordinary unsecured creditors, could be disadvantaged by arrangements e.g., while the Re Marlborough

¹⁶⁶ Company Law and Securities Regulation p 445.

Also asked the question If the company subsequently goes into liquidation before the compromise is paid, are creditors who agreed to the compromise restricted to proving for the lesser sum they promised to accept? - and answered no.

¹⁶⁷ The crown is not bound by s 205 arrangements as there is no provision in Part V of the Act similar to S 113.

Concrete Constructions Pty Ltd case¹⁶⁸ concerned a situation where provision was made in the scheme for preferred claimants to be given a priority this would not necessarily need to be the case¹⁶⁹.

(iii) the crown as a preferred creditor has an advantage over other preferred creditors so far as Section 205 schemes are concerned given that it cannot be bound by such a scheme as there is no provision in part V of the Act similar to Section 113.¹⁷⁰

(iii) The Operation of Preferences in statutory Management : Relevance for preferences in liquidations

Relevant Provisions

The provisions in the Corporations (Investigation and Management Act) 1989 which are relevant to preferences are Sections 65, 51 (particularly subsection (2) and 55; Relevant extracts attached as Appendix IX).

Issues arising which have relevance so far as preferences

¹⁶⁸ (1977-1978) CLC 40,346. Referred to at p 36,551 New Zealand Company Law and Practice (C.C.H.).

¹⁶⁹ In that case the scheme approved provided for a moratorium from the commencement of winding up to and including 1 August 1975 and thereafter in certain circumstances (it was agreed scheme expired 1 August 1975); winding up order made December 1975; Douglas J directed that the liquidator ascertain and/or treat those creditors according to the priorities of the scheme until 1 August 1975. The case followed In Re Walker Construction Co Ltd (In Liquidation) (1960) NZLR 523.

¹⁷⁰ see Walker and Anor v Commissioner of Payroll Tax NSW Supreme Court 1971-1973

in liquidations are concerned

Issue 1 : What is the interrelationship of Sections 65 and 51 - Are the "property or assets" referred to in Section 51(2) the net "property or assets" reduced by the amount of the "costs charges and expenses properly incurred" (referred to in Section 65)?"

This issue was considered in the decision of McDonald v Australian Guarantee Corporation (NZ) Limited.¹⁷¹

As summarised in the Securities Commission report in the Corporations (Investigation and Management Act) 1989:-

"Wallace J concluded that Section 51(2) required them to pay the full amount realised from the sale of an asset subject to a security to the security holder, less only the costs of realising the asset and the amount of any claims under Section 308 of the Companies Act 1955. Accordingly the statutory managers could not seek to defray the general costs of the statutory management against secured assets in priority to the interests of security holders. Wallace J also indicated that in his view it was very unlikely that Section 59 would allow the court to grant the statutory managers the power to do so (this was subsequently confirmed in McDonald v Australian Guarantee Corporation (NZ) Limited (No 2) (1990) 5NZCLC 66,191)"¹⁷².

The situation of statutory Management therefore seems to

¹⁷¹ 4NZCLC 65,365 p 65,371, referred to at page 51 of the Securities Commission discussion paper on the Act July 1991. The case was brought by the statutory managers of the Richmond Smart Group.

¹⁷² Above n171 confirmed in McDonald v Australian Guarantee Corporation (NZ) Limited (No 2) (1990) 5NZCLC 66,191.

be the same as what occurs in a liquidation.

As stated at page fortyfive to fortyeight above the case law (e.g., Re Yoursize Fashions Ltd¹⁷³) appears to establish that the liquidator's costs, charges and expenses associated with the realisation (and by implication also fees/official assignee's commission) are a first charge on the assets. Other general costs of winding up, such as liquidator's remuneration, will, however, only be payable if there is a surplus after the principal and interest of the holders of the charge have been met.

Issue 2 : Why are the Section 308(4)(1)(d) preferences excluded from the statutory Management context?

In the United Kingdom the categories of preferences continued to be Section 55 specifically excludes the "catch all" priority provision of Section 308(4)(1)(d) e.g., the volunteers' Employment Protection Act 1973, Apprenticeship Act 1983, Accident Compensation Corporation Act 1982, Motor Vehicle Dealers Act 1975 and Child Support Act 1992 are not given priority in this context. The fact that such provisions are excluded in this context effectively removes any argument that such priorities are a necessity in the context of liquidations and appears to provide some basis for arguing that there is no sustainable philosophical rationale for preferences.

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¹⁷³ (1990) 5 NZCLC 66,804.

IV The Philosophical bases for preferences - Do they provide firm bases for continuing with preferences or suggest there is a need for reform?

(i) Existing philosophical bases for preferences - as expounded in The Cork and Harmer Reports

In attempting to establish the rationale for preferences one is struck by the lack of material either in select committee policy papers, parliamentary debates, case law or texts as to the specific reasons for their initial introduction or for their categories being added to subsequently¹⁷⁴. In these circumstances it is possible to hypothesise that since their initial introduction on "social" and "public purse interest" grounds in the United Kingdom the categories of preferences continued to be added to there and in other jurisdictions simply on an ad

¹⁷⁴ e.g., in the Inland Revenue Departments' 9 April 1991 Policy Issues Report to the Minister of Revenue concerning Child Support no issue arose as to whether payments should be recoverable where an employer becomes insolvent; it appears that a policy decision was made that such payments should, because of the custodial nature of the regime, be ranked ahead of PAYE tax.

hoc basis¹⁷⁵. It seems that the categories were added to as a result of "pressure group type" influence, from within the government or outside, without any renewed analysis of the appropriateness or otherwise of preferences generally. That is to say that there was no general analysis until the "Cork Report" (1982 United Kingdom) and the "Harmer Report" (1986 Australia) reviewed the regimes in the context of the general insolvency reviews.

The "philosophical bases" for preferences were discussed generally and specifically in both reports. Both reports took the approach that any departure from the pari passu Rule of rateable distribution could only be justified on grounds of "fairness and equity which would be likely to command general public acceptance"¹⁷⁶. Specific bases considered were in respect of the categories of "holiday

¹⁷⁵ The UK regime was introduced in 1888 in section 2 of the preferential payments in Bankruptcy Amendment Act 1897 and it seems likely that these flowed on to other jurisdictions. See Re Barleycorn Enterprises Ltd (supra) Lord Denning MR at page 157 referring to the new meaning of the word "assets" in the light of the equivalent to section 308(4) being introduced referred to the background to the preference provisions:-

"In 1888 and 1897 Parliament began to use the word "assets" in a different sense. It used the word "assets" so as to include not only free assets but also all those assets which were subject to a floating charge. It used the word in this new sense in the statute which created for the first time, "preferential payments". These were rates, taxes and wages. They took priority over a floating charge. This was done by section 1 of the preferential payments in Bankruptcy Act 1888"

¹⁷⁶ The report went on to comment that under the Employment Protection Act a substantial part of an employee's claim, in most cases, was paid out immediately from the Redundancy Fund; that the Employment Protection (consolidation) Act 1978 should be amended to ensure the level of coverage under that Act was the same as under the Insolvency Act and that it should replace the insolvency code provisions relating to employees' preferences.

pay, employees' wages and "Revenue claims".

The Cork report explained the reasons for holiday pay and employees' wages preferences in the following terms:-

" The preferential treatment of employees in an insolvency in respect of their claims for unpaid wages was originally a social measure. It was introduced in an effort to ease the financial hardship caused to a relatively poor and defenceless section of the Community by the insolvency of their employer. In the early days of the Bankruptcy Acts, there was no welfare state, and wages were low. Since then, the position of wage earners has been greatly improved by the introduction of unemployment pay and earnings related benefits, severance and redundancy payments, and other social security benefits ...

There is no doubt that the procedure established under the Employment Protection Acts is a great improvement"¹⁷⁷.

The Cork report recorded that the two grounds put forward for a preference to be given to outstanding tax were because it was owed to the community and because the revenue is an "involuntary creditor". It was considered that money collected on behalf of the crown (e.g., PAYE tax, National Insurance contributions value added tax) attracted a preferences because

- it would be unjust if statutory provisions

¹⁷⁷ One of the stated reasons for continued hardship was the distress caused to employees by the delay in making preferential payments, owing to the need to make detailed computation of the amount of the Crown's preferential claims.

be likely enacted for the more convenient collection of the revenue operated to the benefit of private creditors.

While it is required to have regard to general public acceptance - "it would be commercially impractical to treat moneys collected for the crown as impressed with a trust, and in these special circumstances we have formed the view that the retention of a measure of crown preference is justified."¹⁷⁸

it would be unfair on employees who had had PAYE tax deducted by employers to be liable for the same payment again because the money deducted from earnings was no longer available.

(ii) Are the philosophical bases for preferences expounded in the Cork and Harmer reports appropriate generally and/or in respect of specific matters? What, if any, are the alternatives?

A Appropriateness of philosophical bases at a general level.

As indicated above the "measure" of the appropriateness of preferences, and the consequent departure from the pari passu principle of rateable distribution, was whether such preferences were fair and equitable in a way which would

¹⁷⁸ Cork report p 317. The Harmer Report p 461 stated that any departure from rateable distribution should only be "countenanced by reference to clearly defined principles or policies enjoying general support". See also Justice Department "Inadequacy Law Reform" (December 1988) report which suggested this approach should be applied in New Zealand.

¹⁷⁸ Cork report p 321. At page 323 it was concluded however that the present 12 months period for preference was excessive and that it should be shortened to relate to the period of the intervals between returns.

be likely to command general public acceptance.¹⁷⁹

While it is acknowledged that in a democratic society one is required to have regard to general public acceptance concepts of "fairness" and "equitableness" are necessarily fluid and difficult to define. In addition questions of appropriate "cut off" points arise - where, if anywhere, do the "cutoff" points between "fairness and equity" and "general public acceptance" occur? Can public acceptance continue to be a measure if the principles of "fairness and equity" are undermined?

A more relevant, although not unrelated, measure of the appropriateness of preferences generally would seem to be the degree to which preferences meet with other philosophies of bankruptcy, apart from the principle of pari passu distribution, and the degree to which they impact on the economy and are consistent with the Government's economic philosophy. One of the Harmer report's stated principles, after all, was that "Insolvency Law should, as far as convenient and practical, support the commercial and economic processes of the community."¹⁸⁰ Similarly the concepts of "fairness and equity" would seem to incorporate the notion of economic well being for the country as a whole.

(a) Preferences and the Law of Bankruptcy generally:

¹⁷⁹ Cork report p 317. The Harmer Report p 465 stated that any departure from rateable distribution should only be "countenanced by reference to clearly defined principles or policies enjoying general support". See also Justice Department "Insolvency Law Reform" (December 1988) report which suggested this approach should be adopted in New Zealand.

¹⁸⁰ Harmer Report summary p 2.

Another principle referred to was that equal sharing between creditors should be retained and in some areas reinforced - is that a more appropriate measure?

Preferences are contrary to the view that bankruptcy law is intended to provide creditors with a collective forum to determine relative entitlements.

Thomas Jackson's "The Logic and Limits of Bankruptcy Law"¹⁸¹ discusses the fundamental features of bankruptcy law and provides a useful framework in which to assess the appropriateness or otherwise of preferences in liquidations. Jackson maintains that historically bankruptcy law has had two main functions firstly to allow a financial fresh start for individuals¹⁸² and secondly to provide creditors with a compulsory and collective forum to sort out their relative entitlements to a debtor's assets¹⁸³. In providing a collective forum bankruptcy law aims to permit owners of assets to "use them in a way that is most productive to them as a group in the face of incentives by individual owners to maximise their own positions".¹⁸⁴ (emphasis added) Bankruptcy should only be triggered where it is in the interests of the group.

If one accepts that bankruptcy law exists in response to the need to provide creditors with a collective forum to establish entitlement to debtors' assets then Jackson maintains that the question of how the law should allocate entitlements can and should be seen as one of defining substantive rights. He does not consider it should be seen as a question specific to bankruptcy law, that the concept of "relative value" should duplicate the relative standing among claimants that would exist outside of bankruptcy's collective framework. From accepting that the issue of entitlements is a general issue rather than

¹⁸¹ Jackson, Thomas H, The Logic and Limits of Bankruptcy Law, Harvard University Press Harvard 1986.

¹⁸² This does not apply to corporations.

¹⁸³ Jackson, The Logic and Limits of Bankruptcy Law, p 4.

¹⁸⁴ emphasis added; Above n183.

Really?
But its emphasis on
noting as J.

one specific to bankruptcy then Jackson maintains that the next logical step is to argue that any preferences provided outside those general entitlements are inappropriate. The reason for this is that they could act in a way which is contrary to the general aim of bankruptcy law to maximise the return for the group as a whole. The fact, for example, that a particular creditor has a preference could motivate him/her to initiate bankruptcy proceedings out of self interest rather than for the general benefit of the group¹⁸⁵.

Jackson explains the need to separate the issue of general entitlements from the circumstances of bankruptcy in the following terms:-

"Whether giving workers substantive rights with regard to how assets are used is desirable just as much as whether secured creditors should come ahead of unsecured creditors is a question of underlying government entitlement.

Although protecting the victims of economic misfortune who have not been given the rights against assets may be an important social and legal question, it is not a question specific to bankruptcy law, however the question is answered a bankruptcy statute would still be necessary, because answering these substantive questions one way instead of the other

¹⁸⁵ See, for example Jackson, *The Logic and Limits of Bankruptcy Law*, p 28. Fashioning a distinct bankruptcy rule such as one that gives workers rights they do not hold under non-bankruptcy law, creates incentives for the group advantaged by the distinct bankruptcy rule to use the bankruptcy process even though it is not in the interest of the owners as a group.

does not eliminate the common pool problem".¹⁸⁶

(b) The concept of preferences is generally contrary to the Government's "free market" economic philosophy and "self reliance" Social Policy.

(i) The Government's Economic and Social Philosophy

The concept of the "free market" was originally imprinted on the "national psyche" during the period of the 1984 to 1990 Labour Government via the use of phrases such as "level playing fields", "individual responsibility", and "the need for the clear separation of economic and social objectives and costs" (so that the true cost of social services was apparent)¹⁸⁷. While the general clichés of "free market" and "level playing fields" are not so common in everyday parlance these days, due probably to the fact that these concepts are now "ingrained" if not accepted, there is no questioning of the fact that the present government considers that increased competition and greater self reliance/individual responsibility are the key to economic success.

The emphasis placed on the need for a free market/more competitive enterprise economy is evident from the Government's Economic Strategy set out in Annex 1 to the 2 July 1992 budget. In the strategic overview part of the

¹⁸⁶ Jackson, *The Logic and Limits of Bankruptcy Law*, p 26. He goes on to comment at p 28 that "Bankruptcy law cannot both give new rights and continue effectively to solve a common pool problem. Treating both as bankruptcy questions interferes with bankruptcy's historic function as a superior debt collection system against insolvent debtors"

¹⁸⁷ See extract from July 1990 attached as Appendix X. In the introductory words the Honourable David Caygill reflected on the achievements of the free market economy by listing the notable achievements of the Government.

Annex the Government outlines its strategy for growth together with its social policy. The clear separation of the two policies represents a continuation of the general philosophy that social and economic objectives need to be clearly defined and separated. That if something is socially motivated it needs to be clearly acknowledged and dealt with in those terms. Four elements are combined as part of the Government's strategy for economic growth macroeconomic policies, building international linkages, building a skilled workforce and a more competitive enterprise economy. (Extract from July 1992 Budget attached as Appendix XI) In respect of Social Policy - "fair and affordable social policies" - are seen as an intrinsic part of the government's plan to achieve better growth and employment.

Two elements of the Governments "plan" - "a competitive enterprise economy" and "fair and affordable social policies" are particularly relevant in considering how the concept of preferences fits in with the government's economic policies. The Government regards "Intense competition, aided by openness to world markets as the major driver for better innovation, management performance and overall efficiency" and refers to a number of recent developments creating a competitive cost structure - the Employment Contracts Act¹⁸⁸, ongoing taxation reform¹⁸⁹, resource management reform¹⁹⁰, energy sector reform¹⁹¹,

¹⁸⁸ Reference is made to the Employment Contracts Act enabling firms to make more "innovative use of labour".

¹⁸⁹ e.g., Government has revised the criteria used by the Commissioner of Inland Revenue in setting depreciation rates to bring rates closer to economic rates.

¹⁹⁰ Page 75 "The Act places the responsibility on local and regional authorities to use the lowest - cost means of managing the environmental effects of development".

more efficient provision of transport infrastructure¹⁹², more efficient public sector, commercial law reform¹⁹³. So far as "fair and affordable" social policies are concerned the Government again places emphasis on the need for self reliance and fairness.¹⁹⁴

"Better performance" is stated to be improved via "enhanced security/growth" which in turn is aided by a decline in social services expenditure as a percentage of Gross Domestic Product¹⁹⁵. A "fairer system" is said to result from people in similar circumstances being given

¹⁹¹ Above n191. It is another step in moving to efficient cost structures.

¹⁹² The Government wants to ensure that major assets such as ports and airports operate as efficiently as possible.

¹⁹³ In referring to the reforms that are taking place in the comprehensive review of commercial law - Companies Legislation, takeovers and financial reporting legislation, supervisory structure of securities market, insider trading and statutory management legislation Commerce Act 1986, Intellectual Property legislation - reference was made to the potentially large effects on management performance and, company efficiency promotion of competitive business and rewards of innovation that would occur.

The document the went on to comment that the Government welcomed "advice from the private sector on any regulatory impediments which make it difficult for business to respond to the challenge of the international market place". (page 78)

¹⁹⁴ page 85.

¹⁹⁵ page 86.

similar assistance.¹⁹⁶ Despite the emphasis on "equality" and "fairness", however, there is still some scope for "targeting"/subsidising those who are "less well off" or those who are considered deserving on an "interest group" basis¹⁹⁷.

(ii) The relationship between the Government's "free market" philosophy "self reliance" social policy and the concept of preferences

Clearly the fact that preferences favour one creditor over another is in contrast to any free market philosophy and contrary to any strict self reliance social policy. Given the scope within the Governments' present philosophy to target deserving groups as beneficiaries, however, it is still arguable that "socially based" preferences are consistent with Government Economic Policy. It is equally arguable though that present policy makes it more appropriate for "socially based" preferences to be dealt with in the Social Welfare forum rather than in the preferential creditor forum. The question that therefore arises is whether or not the specific "socially based" preferences are consistent with the Governments' greater self reliance view? - Are the priorities given to employees' wages or salary, holiday pay, Accident

fly

¹⁹⁶ The example is given at page 88 that "for instance, before the housing reforms were announced, Housing Corporation tenants on average effectively received a \$70.00 per week subsidy and mortgagees \$40.00 per week, with Department of Social Welfare accommodation benefit clients on average receiving only \$22.00 per week.

Rental and interest rate increases for Housing Corporation clients, and increased assistance for some Social Welfare clients, will reduce the unequal treatment between these two groups".

¹⁹⁷ e.g., At p 91 reference is made to the governments' public discussion document "support for Independence" on disability support services.

Compensation payments justified? Should other payments such as redundancy payments be included?

It is arguable that the targeting of groups by "class" (e.g., employees rather than self employed creditors) rather than income levels at time of liquidation or a combination of income levels and class is, for example, contrary to social policy in other areas. Sickness benefits, for instance, are payable to unemployed people who would otherwise be employed, and people who would be otherwise self employed. Similarly the relevant stand-down periods and levels of payment are determined by income levels. Any reduction in National Superannuation via the requirements to pay a surcharge, for example, is dependant on level of income rather than the source of the income. Similarly redundancy payments are regarded as income do the purposes of calculating unemployment benefits so why should they be treated differently from wages for preferential payments purposes?

(c) Preferences have direct and indirect economic effects which need to be taken into account.

(i) Economic/risk analysis of Preferences generally

It is acknowledged that any consideration of the economic effects of specified statutory preferences is inseparable from the types of arguments arising in respect of priorities generally. Why, for instance, should secured

(11) If the initial creditor takes a secured loan, it generally has priority over later creditors in the assets in which it has security, although there are several exceptions to this principle.

¹⁰ Above 2190 Schwartz maintains, amongst other things, that the law regulating priorities should reflect the priority contract that a debtor and its initial financier would negotiate.

¹¹ In the case of England and New Zealand.

creditors be given priority over unsecured creditors?¹⁹⁸
 If it is accepted that secured creditors should have a priority should the priority rules hold independently of the contract between the initial financier and the debtor?¹⁹⁹

In the context of statutory preferences, however, issues that seem to arise include what are the effects of relegating secured floating charge holders below unsecured preferential claimants?²⁰⁰ What effect do preferences have on the principle of equality in distribution among unsecured creditors?

While the specific effects are unquantified the nature of the economic implications has been referred to in the Cork report, by commentators, and in the recent submissions to the select committee on the Companies Bill. Peat Marwick's submission to the Select Committee explained the impact of preferences generally in the following terms:-

"Because of preferences it is virtually impossible to

¹⁹⁸ A Schwartz, "A Theory of Loan Priorities", Journal of Legal Studies Vol. XVIII (June 1989), p 209) Refers to three priority principles governing current law:-

(i) if the first creditor to deal with the debtor makes an unsecured loan it shares pro rata with later unsecured creditors

(ii) if a later creditor takes security the later creditor has priority over the initial creditor in the assets subject to the security interest

(iii) if the initial creditor makes a secured loan, it generally has priority over later creditors in the assets in which it has security, although there are several exceptions to this principle.

¹⁹⁹ Above n198 Schwartz maintains, amongst other things, that the law regulating priorities should reflect the priority contract that a debtor and its initial financier would negotiate.

²⁰⁰ In the case of England and New Zealand.

trade a company out of receivership, and the method by which companies are financed by banks in the main has changed substantially.

For the smaller business it is now virtually impossible to raise both finance on the assets of a company and to be fair to the banking system a perfectly reasonable attitude.

Preferences have now so evaded the financial base of the company in receivership or liquidation, and unless a banker has some form of additional security outside of the company, there is a strong chance that he would not be repaid his overdraft and term loan indebtedness²⁰¹.

The Cork Committee and Alan Schwartz²⁰² have both referred to the effects of preferences on financing arrangements, and the specific effects of floating charges on these arrangements. It has been accepted that the increased burden of preferential debts can lead to banks and other creditors seeking to increase the fixed and reduce the floating element of their security, taking fixed charges instead of floating charges over present and future book debts²⁰³ and adjusting interest rates to take account of the relatively more exposed financial position. The fact that lending institutions may in fact be in a position to compensate for distortions caused in itself provides a possible basis for arguing that other individuals who cannot take such steps should be protected. For example, if one of the creditors is a worker owed a week's wages or a Tort victim and the other is a bank?

²⁰¹ Page 10 paragraph 3.4

²⁰² A Schwartz "A Theory of Loan priorities", Journal of Legal Studies Vol XVIII.

²⁰³ Cork report p 357 paragraph 1583.

(ii) Indirect economic costs of preferences

While unquantifiable there is undoubtedly an economic cost stemming from the existence of large numbers of preferences which needs to be taken into account in any dividend calculation²⁰⁴. In considering the desirability or otherwise of preferences and the need for reform these hidden costs need to be taken into account. While any administrative costs associated with calculating the debts and dividends of a company in liquidation are of a far lesser scale than the "tax system" calculations it seems desirable that a similar approach is taken to administrative costs as occurred with the 1990 Consultative Committee on Tax Simplification, and in the area of Goods and Services Tax.

In accepting the recommendations of the Consultative Committee on Tax simplification²⁰⁵, including administrative amendments, the Government acknowledged that there were unacceptably high economic costs in having an overly complex system which placed high administrative cost burdens on small businesses and the Department of

²⁰⁴ The situation is further complicated in those jurisdictions where the priority over floating charge holders requires floating charge holders interests to be quantified.

In addition in New Zealand divergencies that occur between the operation of preferences in liquidations compared with receiverships have to be taken into account.

²⁰⁵ The Government's budget of 24 July 1990 presented by the Honourable David Caygill refers to the report and to its findings.

Inland Revenue²⁰⁶. Similarly in introducing Goods and Services tax regard was had to the need to keep the operating costs of the tax, of the Inland Revenue Department and of registered traders as low as possible²⁰⁷. The need to ensure that the total operating cost was not disproportionate to the expected revenue was also emphasised.

Further analogies can probably also be drawn between Goods and Services Tax and the negative effects of preferences on unsecured creditors and floating charge holders. It has been acknowledged, for instance, that exemptions, zero rating and multiple rates in the context of Goods and Services Tax can erode the tax base by measurable²⁰⁸ and unquantifiable²⁰⁹ amounts and that they have "effects on horizontal equity". People with identical incomes and needs, but with different preferences for taxed and untaxed goods, pay different amounts in tax".

²⁰⁶ Above n206, pp 22-24. The major decisions taken related to three areas - aligning of tax payment dates and systems for various taxes; relieving compliance costs for small businesses and redoing the level of record keeping required for a number of taxes.

²⁰⁷ See for example Carl Bakker and Phil Chronican, *Financial Services and The GST*, Victoria University Press for the Institute of Policy Studies. Wellington 1985 p 8.

²⁰⁸ Claudia Scott, Peter Goss and Howard Davis, *The incidence of Indirect Taxes*, Vol. 1, Victoria University Press for the Institute of Policy Studies page 38
e.g., it was estimated that the exemption of food consumed at home reduces the potential tax base rate by around 20%.

²⁰⁹ Above n209, p 38 e.g., the departure from a uniform tax rate leads to a distortion of demand to untaxed items which may result in a less efficient allocation of resources than under a uniform system.

B Appropriateness of philosophical bases at a specific level.

While the above analysis raises a number of reasons for abolishing preferences²¹⁰ the continued existence of preferences in other jurisdictions suggests that they will continue to exist in New Zealand and consequently there is merit in considering the bases/suitability of the specific preferences that exist.²¹¹

(a) Existing "Unsecured" Preferences

- (i) Revenue claims - Are the Harmer and Cork Report views that preferences should only be retained in cases where the revenue is acting as a trustee still appropriate?

The Reports' findings

The Cork report considered that, while there had been two grounds put forward for a preference to be given to outstanding tax (because it is owed to the community and because the revenue is an "involuntary creditor") a preference was not justified (except in cases where moneys had been collected on behalf of the Crown) for a number of reasons:-

- "A bad debt owed to the state is likely to be insignificant in terms of total Government

²¹⁰ i.e., they are contrary to; the view that bankruptcy law is intended to provide creditors with a collective forum to determine relative entitlements; the Governments "free market" economic philosophy and have undesirable direct and indirect economic costs.

²¹¹ e.g., as measured against the reasons put forward in the Cork and Harmer reports and the rationale for/alternatives to the existence of the diminished priority of floating charge holders.

receipts - the loss of a similar sum by a private creditor may cause substantial hardship, and bring further insolvencies in its train"

- the revenue's position is greatly strengthened by granting by Parliament of additional powers to raise assessments and to charge interest on unpaid or late paid tax²¹². i.e., "it has recourse to exceptional remedies which are not available to the ordinary creditor".

- there are many other involuntary creditors e.g., victims of breach of contract and Tort.

- a substantial proportion of tax lost through abolition of preferences would "no doubt be recouped from the increase in dividends payable to ordinary commercial creditors, thereby reducing the amount of bad debts written off by them against trading profits".

The Harmer report also referred to the reasons given by the Cork report as indicating that Revenue preferences were undesirable and raised the following additional reasons:-

- "the Commissioner's priority assures the Taxation Department of payment and it consequently makes little effort to recover it in a normal commercial manner

- the Commissioner, by allowing taxation debts to accumulate without real risk to the

²¹² It has powers to impose penalties and possesses remarkable powers to enable it to obtain information, including where necessary powers of entry, search and seizure ...

Commissioner's position, may seriously disadvantage the interests of other unsecured creditors who are not in a position to make an informed decision as to the financial position of the debtor and will doubtless suffer in the ultimate distribution of the estate.

the commissioner should get no greater priority than would a creditor for debts misappropriated by an agent. There would be a significant reduction in litigation over the scope and operation of the Commissioner's priority.

In its 1988 review the Justice Department commented that the crown enjoyed a particularly strong position in insolvency law, summarised the "pros and cons" arguments put forward in the Cork and Harmer reports and supported the Harmer proposal that revenue claims be abolished given that "There is no indication that the abolition of the priority will endanger the revenue. As well it is inequitable to force unsecured creditors to forgo their legitimate claims, so that revenue claims could be paid first"²¹³.

Comments

The reasons given by the reports can probably be questioned firstly on the grounds that they fail to acknowledge that the "public/community purse" is a different entity from a private creditor. While it can firmly be argued that the free market philosophy requires a lack of subsidy/preference to ordinary creditors and requires a more efficient public sector it is not so clear that it extends to the Government being required to compete for tax revenue itself, especially when it is

²¹³ Justice Department "Insolvency Law Reform" (December 1988) Report page 109.

still acknowledged that there is a place for "targeted" welfare assistance.

A further ground for questioning the reasons given is that they appear to be outdated. They do not acknowledge, for instance, the increased accountability of the Commissioner of Inland Revenue over recent years, the increased computerisation of the Department and the Commissioner's clear commercial approach to debt collection which is recorded in the Inland Revenue Department's reports. It is clear from the performance reports for the periods ended 30 June 1991 and 31 December 1991 that while the amount of collectable debt and total debt has increased significantly, the level of collectable debt outstanding has significantly reduced, and the performance related to debt collection has improved. Two performance standards for Return Management²¹⁴ recorded the following

²¹⁴ A "programme division" of the Inland Revenue Department.

achievements as at 30 June 1991 and 31 December 1991:-

<u>Performance Standard</u>	<u>30 June 1991</u>	<u>31 December 1991</u>
	<u>Performance</u>	<u>Performance</u>
1. Collectable Debt	Achieved	Exceeded
80% of \$ collectable debt to be collected within six months of identification of arrears	Percentage Collected was 84.19%	Budgeted 80% actual 86.58%

3. Collection Unit	Exceeded	Budgeted
Achievement of the revenue target of \$75 million for 1990 - 91 and 1991 - 92 by the Collections unit	Collected \$92.6m	\$37.5m Actual \$55.3m

Again the question of whether it is valid to continue revenue preferences (including situations where money has been collected on behalf of the crown) needs to be answered in the context of the government's/country's economic and social philosophy²¹⁵ e.g., if the intention is to provide a relatively cheap debt collecting mechanism

²¹⁵ Having regard to necessary statistical and economic data so that appropriate decisions can be made.

for the crown²¹⁶, and this is justified on economic efficiency grounds²¹⁷, then it may be appropriate to continue and add to existing preferences. Given that the revenue can be distinguished from other creditors it might be more appropriate, however, to address the means of providing it with a priority rather than the giving of a priority. It may for instance be appropriate to adopt tax liens, having secured creditor status, and eliminate other unsecured creditor preferences.

(ii) Holiday Pay, Employees' Wages

It seems unquestionable that these preference were introduced to alleviate "the financial hardship caused to a relatively poor and defenceless Section of the community by the insolvency of their employer"²¹⁸ in the absence of a welfare state. Even ignoring the question of whether the notion of "fairness and equity command general public acceptance" is an appropriate measure of the appropriateness of a preference questions that arise are do these circumstances still exist? If they do are they confined to that Sector? Are the problems more appropriately dealt with in another context?

Apart from the fact that present social and economic

²¹⁶ It may be that the Government considers, as have many governments and monarchy's before, that the public "coffers" /consolidated fund's needs override all other considerations and in any case such an approach is not consistent with general accountability arguments e.g., accountability can be regarded as relating to expenditure matters rather than debt collection, in any case Inland Revenue's debt collection mechanism has greatly improved, it has been accountable see, for example, Annual report for year ended 30.6.91 pp 22-26 and half yearly report for 23/6/91 to 31/12/91 pp 23 to 28.

²¹⁷ To the economy as a whole and individual tax payers and creditors.

²¹⁸ The Cork Report page 324.

policy probably requires that these matters should be identified as welfare assistance and be dealt with in a different context from creditor preference there is undoubtedly some "unfairness" in excluding others from assistance. Why should, for example, redundancy payments be excluded? Why should self employed people who suffer as a consequence of an insolvency not be given assistance? Would it not be fairer to use income as a base rather than the category or source of payment?

(iii) The other preferences referred to in Section 308, including those invoked via other statutes, and those preferences coming after Section 308 but before floating charge holders.

When looking at the other statutes which provide a preference via Section 308(ca) and 308(1)(d) one is perhaps most struck by their "diversity" and "antiquity" and is left wondering why those provisions rather than others? why the particular order?²¹⁹ Section 308(ca), for example, provides a preference to "all amounts deducted by the company from the wages or salary of any employee in order to satisfy obligations of the employee" and, amongst other things, covers Unpaid Child Support Deductions which are deducted from an employee's wage/salary under the

²¹⁹ This is the question asked by a number of people making submissions to the select committee on the Companies Bill - e.g., Coopers and Lybrand submitted that the Motor Vehicle Dealers Institute, ACC and Radio Communications Act provisions should not be given a preference. The New Zealand Society of Accountants also referred to the need for fees arising under the Radio Communications Act 1989 to be excluded.

Child Support Act 1992.²²⁰ Given that the employer in this instance is acting in a custodial trustee relationship for the Inland Revenue Department a question that arises is why is such a payment given equal priority with the other Section 308 matters when PAYE tax, withholding tax and Goods and Services tax rank after those matters²²¹.

Similarly, questions arise as to the appropriateness of the preferences under Section 308(1)(d). "Apprenticeship", for example, seems to be an institution of "by gone" days. Why should such a relatively small number of employees be given a preference over other equally vulnerable sections of the workforce and community?²²² Even if there were a large number of people seeking compensation via the Volunteers' Employment Protection Act 1973, which seems doubtful, one wonders

²²⁰ The preamble to that Act states that it is an Act:-

- (a) To assess the minimum level of financial support payable by certain parents in respect of their children, and
- (b) To provide for the collection and payment of child support and spousal maintenance payments, and
- (c) To make transitional arrangements relating to maintenance liabilities under the Social Security Act 1964 and the Family Proceedings Act 1980.

²²¹ No issues arose in the Inland Revenue Department's 9 April 1991 Policy paper as to whether payments should be recoverable where an employer becomes insolvent.

One must assume that a policy decision was made that the custodial nature of the regime warranted the payments ranking ahead of PAYE tax.

²²² 4,414 apprenticeships were entered into between 1 July 1990 and 30 June 1991. Education Training and Support Agency statistics. Statistics for the year ended 30 June 1992 were not available but total of apprenticeships entered into for the period 1 July 1988 to 31 March 1989 were 5,611.

whether a maximum compensation priority of \$200.00 would be of great assistance in any case. Similarly why should it be, especially in days of deregulation, that money, paid out of the Motor Vehicle Dealers fidelity funds do not have such coverage²²³. What special relevance can it be said that license fees owing under the Radio Communications Act 1989 have that warrant them being given a priority?

The same questions can be raised in respect of debts, apart from tax debts which have been discussed previously, ranking after the preferential debts in Section 308(1) and before floating charge holders. What bases can be said to exist for preferring those creditors over other creditors who have paid money in advance and not received goods in return or alternately creditors who have provided goods and not been paid?²²⁴

(b) The floating charge versus preferential claims priority and alternative solutions.

The fact that in New Zealand all statutory preferences can take priority over floating charge holders, where there are insufficient assets to meet those priorities, is a matter of great significance given it is contrary to the fundamental principle that secured creditors take in priority to unsecured creditors. This situation necessarily raises the question of whether or not

²²³ Without doubt the Law Society fidelity fund would have had larger calls on its fund in recent times - why should it not have coverage? what about the Real Estate Institutes' fund?

²²⁴ Wellington District Law Society submitted to the Select Committee that Layby Sales Act provisions should not be given a preference. Peter Watts submitted that restitution claimants and consumers who paid in advance for goods and services by ticket or mail order should also be included.

distinctions between the treatment of fixed and floating charge holders should continue? If such a distinction is to continue what form should it take?

There do not appear to be any documented reasons for the difference in treatment of fixed and floating charges. Some "modern financial theories" indicate, however, that there are strong economic justifications for the unusual position held by floating charge holders and in these circumstances it is arguable that the distinctions should be retained. Robert E Scott²²⁵ for instance, in considering the apparently favoured situation of floating liens under the United States Code concludes that²²⁶:-

".... those provisions of Article 9 that appear to advantage the senior creditor with a floating lien are explained by the benefits that the relational²²⁷ theory predicts will accrue to all participants from the success of the financing venture.

On the other hand, there is a need to confine the potential leverage security offers such creditors; this need is the key to understanding both Article 9 and the Bankruptcy Code limitations on the floating lien creditor".

While it seems likely that similar reasons, to those given

²²⁵ In his article "A Relational Theory of Secured Financing", Columbia Law Review, June 1986 page 901.

²²⁶ Above n225, p 90.

²²⁷ Above n226 Scott comments on conventional and recent financing theories and suggests that they start from a narrow idea of the function of collateral and of the debtor - creditor conflicts it aims to stop. He maintains that the impetus for secured financing in fact comes from the financing relationship itself and from the parties' wish to exploit it fully.

not Scott's
points

in the United States, for continuing with the distinctions in priority between fixed and floating charges would exist in New Zealand once again quantifiable data would need to be obtained before reaching such a conclusion. It is noted, for instance, that Scott's relational theory was tested against extensive analysis of information gathered on the functioning of credit markets²²⁸.

If it was decided to continue with the fixed and floating charge distinction so far as priorities are concerned the effects of the Proposed Personal Property Securities Act would need to be considered. Is it possible, given that that Act dispenses with distinctions between fixed and floating charges, to give floating charge holders the "lesser priority" currently operating under Section 308(4) of the Companies Act 1955?²²⁹ In general terms it appears that the use of "after acquired property" and "future advances" clauses in a blanket agreement under the Personal Property Securities Act do create the equivalent of "floating charges"²³⁰ the security interest could be said to have "attached" to property that has in fact been acquired or to advances that have been made at the time of

²²⁸ See for example p 904 and pp 933 - 952. Data was, for example gained from priority disputes decisions, industry reports and standard form security agreements.

²²⁹ One of the general features of the proposed Act is that the fundamental concept is security interest and consequently the distinctions between fixed and floating charges is dispensed with.

See The Law Commission, A personal Property Securities Act for New Zealand, (Report No 8) (Wellington, 1990); clause 4 of the proposed Bill.

²³⁰ The Law Commission Report No 8 discusses this matter at p 109. It refers to the fact that under the proposed statute a creditor can obtain a floating security interest by means of a clause granting the creditor a security interest in all of the debtor's presently owned and after acquired property.

winding up²³¹.

If it was decided that there the present regime relating to floating charge holders should be changed then possible alternatives appear to indicate one or more of the following:-

- (i) a reduction of the number and quantity of preferential claims would increase the availability of funds for floating charge holders
- (ii) floating charge holders could only be subordinated to some debts (as in Australia) or could be subordinated via avoidance provisions (as occurs with Section 447 of the United States Code)²³²
- (iii) the differentiation between fixed and floating charges should be retained but floating charges

²³¹ It is accepted that a creditor will only obtain a security interest in after acquired property and future advances upon the debtor's acquisition of the goods or advances.

The Law Commission Report No 8 discusses this matter at p 109.

²³² If such an approach was adopted however, the issue of when a security interest in fact arose would need to be addressed.

Whereas it is currently considered, for the purposes of the voidable preference provisions in the Companies Act 1955 (e.g., ss 309 and 311) that the security interest is created when the charge is registered (ss 102 and 103) under the Proposed Personal Property Securities Act a creditor only obtains a security interest in after acquired property upon the debtor's acquisition of the goods. Consequently it could be argued that securities are given at a later date under the proposed Act than is presently the case. (The Law Commission Report No 8 discusses this matter at p 109).

should lose their priority over unsecured creditors²³³. The general body of creditors should participate not like preferential creditors in priority to holders of floating charges, but pari passu with floating charge holders in the distribution of proceeds of assets comprised in the charge.²³⁴

- (iv) differentiation between fixed and floating charge holders should be retained but all secured creditors should lose the same percentage of their security as floating charge holders²³⁵

²³³ The Cork report p 345 made the suggestion and commented in the way referred to.

²³⁴ This would:-

- (a) increase the amount available to ordinary unsecured creditors, and ensure a fairer distribution.
- (b) reduce the number of small businesses going under by increasing the dividends payable to unsecured creditors.
- (c) involve the receiver, more closely with ordinary creditors by giving ordinary creditors the right to participate in the proceeds realised by a receiver.

It was suggested that a fund equal to 10% of the net realisation of assets subject to a floating charge should be made available for distribution among ordinary unsecured creditors.

²³⁵ Submissions 9 and 49 of the select committee submissions on the Companies Bill consider floating charge holders. Submission 9 considers clause 9(b) unfairly discriminates against these credits and states that all secured creditors should lose the same percentage of their security. It recommends that clause 9(b) should apply to all secured creditors and not just to floating charge holders. To the extent that the value of any security exceeds the debts secured, the excess value should be ignored for the purposes of calculating the subsidy to be given to the preferred creditors.

VII (v) any differentiation between fixed and floating charge holders should be removed.

(ii) Changes proposed in the Companies Bill or in the Ancillary Provisions Bill are significant.

While the Law Commission elected to leave the law on preferential claims unchanged for convenience and to simply list all preferential claims in Section 239... and the subsequent Companies Bill have virtually adopted the Law Commission's draft bill in its entirety, some significant changes have been introduced.

relevant provisions are now contained in 3 clauses in the Bill and a schedule rather

²⁴ Page 164 paragraph 747.

²⁵ Above n237; other unsecured claims are governed by section 240.

²⁶ The Companies Bill virtually adopted the Law Commission's draft bill in its entirety, although instead of listing the preferential claims in the body of the Act listed them in a schedule (clause 275 of the Companies Bill and the seventh schedule).

The Ancillary Provisions Bill made no amendments and simply changed the section number and schedule number of the preference provisions (now clause 366 and schedule 8c).

References in this paper are to the numbers used in the Companies Bill rather than the ancillary provisions bill for ease of reference given that select committee submissions refer to the Companies Bill provisions.

²⁷ Some purposefully, others possibly inadvertently.

²⁸ Clause 241 Expenses of liquidation; cl 268 rights and duties of secured creditors; cl 275 Preferential Claims and the Seventh Schedule.

VII Proposed Reforms - will the proposed amendments to the Companies Act resolve identified structural problems? What longer term action is needed to make preference law more accessible and soundly based?

(i) Changes proposed in the Companies Bill so far as liquidations are concerned

While the Law Commission elected "... to leave the law on preferential claims unchanged for convenience"²³⁶ and to simply list "all preferential claims in Section 239...."²³⁷, and the subsequent Companies Bills²³⁸ have virtually adopted the Law Commission's draft bill in its entirety, some significant changes have been introduced²³⁹:-

- relevant provisions are now contained in 3 clauses in the Bill and a schedule²⁴⁰ rather

²³⁶ Page 164 paragraph 707.

²³⁷ Above n237; "other unsecured claims are governed by section 240".

²³⁸ The Companies Bill virtually adopted the Law Commission's draft bill in its entirety, although instead of listing the preferential claims in the body of the Act listed them in a schedule (clause 275 of the Companies Bill and the seventh schedule).

The Ancillary Provisions Bill made no amendments and simply changed the section number and schedule number of the preference provisions (now clause 266 and schedule 8c).

References in this paper are to the numbers used in the Companies Bill rather than the ancillary provisions bill for ease of reference given that select committee submissions refer to the Companies Bill provisions.

²³⁹ Some purposefully, others possibly inadvertently.

²⁴⁰ Clause 241 Expenses of liquidation; cl 268 rights and duties of secured creditors; cl 275 Preferential Claims and the Seventh Schedule.

than via cross references to the Insolvency Act, in the case of secured creditors²⁴¹, Sections 261, 299 and 308 of the Companies Act and Rule 168 of the Companies Winding Up Rules.

- Distinctions between voluntary and compulsory winding ups no longer occur in the legislation generally or in relation to preferences specifically²⁴².
- the seventh schedule purports to list all priorities, including those presently in Rule 168 and those currently invoked via other legislation. The New Zealand Society of Accountants' submission to the select committee refers to the fact that preferential claims under Section 183 of the Radio Communications Act 1989 and those given to the Collector of Customs appear to have been omitted however.
- the ranking order of PAYE and GST has been changed²⁴³. At present PAYE, GST and Layby Sales Act provisions rank immediately after preferential claims but rank equally amongst themselves. Clauses 3 and 4 of the seventh schedule in effect mean Inland Revenue Department claims rank last.
- the definition of "floating charge" has been

²⁴¹ In a company liquidation, s 90 of the Insolvency Act 1967 applies by virtue of s 307 of the Companies Act 1955.

²⁴² Clause 241 is the only clause referring to expenses of liquidation, although the seventh schedule listing the preferential claims in priority order also refers to fees and expenses.

²⁴³ New Zealand Law Society submission raises this point.

excluded i.e., the expression "floating charge" includes a charge that conferred a floating security at the time of its creation but has since become a fixed or specific charge²⁴⁴". The exclusion of the definition of "floating charge:", which was inserted by the 1980 amendment, will re-raise the problems which occurred before that amendment i.e., arguments that crystallised charges are in fact fixed and not floating and therefore entitled to a secured interest "priority".²⁴⁵

- changes have been made to the Accident Compensation provisions (7c of schedule 8c c/f Section 308(c)).

(11) - the present basis for charging the maximum amount that may be paid as a preferred claim in respect of wages and salary of an employee has been changed; "at present it can be increased by the Governor General by order in Council clause 5 of the seventh schedule states that the amount may not exceed \$6,000 or such greater amount as is prescribed at the commencement of the

²⁴⁴ Above n243 comment that "an ambiguity remains as to whether the claims in clauses 2, 3 and 4 still have priority if the floating charge has crystallised and become a fixed charge".

It is unclear why this definition of a floating charge has been excluded, although it is noted that it was also excluded from the Law Commission's report No 9 draft bill. Was it intended that the Personal Properties Security Act provisions would make such a definition unnecessary.

²⁴⁵ This matter was raised by a commentator at the May 1992 meeting of the Wellington Insolvency Practitioners.

liquidation²⁴⁶ .

- the seventh schedule did not recognise the preferential treatment under present law to excise duties owing to the collector of customs²⁴⁷.

- "relevant date" which for the purposes of Section 308 does not relate to the commencement of winding up but to the date of the court order or passing of a resolution (in the case of a voluntary winding up), has been excluded. The term "commencement of the liquidation" is referred to throughout the provision.

(ii) Changes proposed in the Companies (Ancillary Provisions) Bill in respect of Preferences in Receiverships

Part V of the Companies (Ancillary Provisions) Bill deals with Receiverships and clause 158 covers preferential claims. As with Section 101 of the Companies Act 1955 clause 158 invokes the preference provisions of the seventh schedule by cross reference (via clause (2)(b))²⁴⁸ but the provision differs from Section 101 in so far as there is a specific statutory reference to expenses and remuneration of receivers being met out of assets of the property i.e., clause 158(2)(a) provides :-

²⁴⁶ This point is referred to in the New Zealand Law Society and District Law Society submissions to the select committee.

²⁴⁷ Society of Accountants submission.

²⁴⁸ The seventh schedule, except clause 1 which relates to costs and expenses (presently covered in r 168 of the Companies Winding up Rules)

"....(a) First, to reimburse the receiver for his or her expenses and remuneration, to the extent that full reimbursement cannot be made out of other assets forming part of the property in receivership; and"

Does the Bill rectify the present discrepancy whereby statutory provisions and relevant time limits vary according to whether a receiver is appointed prior to liquidation?

While clause 158(1) provides that the preferential claims clause "applies to a grantor that is a company other than a company in liquidation", and could be said, by implication not to apply to a company that has been in receivership and subsequently goes into liquidation or continues in receivership and goes into liquidation, I do not consider this is the effect of the provisions as a whole. The fact, for example, that clause 159 provides that a receiver can continue to act as a receiver and agent of the liquidator suggests that clause 158 still applies where a company has started off being in receivership and subsequently goes into liquidation. In these circumstances the time differentials that currently occur under the Companies Act still apply.²⁴⁹

Other apparent "problems" with Receivership provisions in the Bill

Other "problems" with the provisions include the following:-

²⁴⁹ As with s 308 the time periods referred to in cl 2 of the seventh schedule apply from the date of the appointment of the receiver rather than from the "commencement of the liquidation"

Clause 220 of the Bill refers to the various circumstances constituting the "commencement of liquidation".

- (i) While clause 158 invokes the preference provisions of the seventh schedule it does not appear to invoke Section 276 which provides, amongst other things, that the preferential claims "rank equally amongst themselves and must be paid in full, unless the assets are insufficient to meet them, in which case they abate in equal proportions"²⁵⁰
- (ii) There is still no statutory provision stating where receivers' costs rank in relation to the costs and expenses of any liquidator in preserving and realising assets²⁵¹.

(iii) Schemes of Arrangement under the Companies Bill and Companies (Ancillary Provisions) Bill

Part XIII of the Companies Bill deals with "Compromises with Creditors". It by and large reflects the draft Law Commission Bill and in the Law Commission report the proposed provisions were summarised as follows:-

".... is designed to provide a more useful procedure which features a greater provision of information by those proposing a compromise but limits the role of the court to one of review on specified grounds...."

²⁵⁰ e.g., there is no equivalent to s 276 claims of other creditors and distribution of surplus assets:-

"(1) After paying preferential claims in accordance with Section 275 of this Act, the liquidator must apply the assets of the company in satisfaction of all other claims.

(2)...."

²⁵¹ As stated at pg 64 above on the basis of case law "a receivers' costs and expenses rank ahead of statutory preferential claims but after the costs and expenses of any liquidator in preserving and realising assets".

.... the ability of a 75 percent majority to bind the majority of relevant creditors is retained in Section 198 but is subject to notice of the proposal being given to a creditor as well as the grounds for challenge set out in Section 200(2).

The details of information required support the central theme that the compromise must be able to be properly considered by creditors affected and opportunity afforded for other views to be made known."

It still seems that some preferential, as well as unsecured creditors, are potentially "disadvantaged" under the Bill. For instance, only 75% approval for a proposed scheme is still needed under clause 216 (although court sanction is no longer needed but rather 75% of votes validly cast by creditors or class of creditors is required).

Other features of the Bill include:-

(i) a receiver appointed in relation to the whole or substantially the whole of the assets and undertaking of the company is able to propose a compromise and consequently the scope for "contracting out" of the preference provisions is extended.²⁵²

(ii) the Crown is now bound by any scheme and does not have an advantage over other preferred

²⁵² clause 214.

creditors.²⁵³

(iv) Will the proposed amendments to the Companies Act resolve identified structural problems? What other action is required?

Undoubtedly the simplification of the regime occurring as a consequence of the elimination of compulsory and voluntary winding up, coupled with the reference to priorities in one schedule, will assist considerably in making the law more accessible. The fact that the terms "assets", "expenses" of liquidation "fees" and "remuneration" continue to be undefined and are used in more than one place however may mean that problems as to meaning and priority may continue to arise or be exacerbated²⁵⁴.

(a) What longer term action has been identified as needing to be taken?

Apart from referring to structural matters a number of select committee submissions identified philosophical matters relating to the need or otherwise for specified preferences/amended preferences. These references reinforce the need for a detailed review, of the bases for and desirability of preferences/groups of preferences, in

²⁵³ Section 5 in Part 1 of the Act provides that "this Act binds the Crown"

i.e., the situation, as previously stated, does not exist - "it (the Crown) cannot be bound by such a scheme as there is no provision in Part V of the Act similar to s 113".

²⁵⁴ While the common law to some degree, has become settled in respect of these matters the changed words could result in new arguments being raised. The apparent change in priority of GST and PAYE tax could result in new litigation.

the context of general economic and social policy²⁵⁵. The New Zealand Law Society expressed its disappointment that there had been no fundamental rethinking of the preferential claims regime and called for a reconsideration of its "purpose and priorities". Specific matters raised relating to the need to reduce specific preferences include the following:

- requirement that the audit office should have to approve out of pocket expenses for committees of inspection should be abolished²⁵⁶.
- the Layby Sales Act provisions should not be given a preference²⁵⁷.
- a time limit should be imposed on preferential tax claims²⁵⁸.
- Motor Vehicle Dealers Institute, ACC and Radio Communications Act provisions should not be given a preference²⁵⁹.

²⁵⁵ As at 8 July 1991 there were 46 submissions tabled and released by the Justice and Law Reform Select Committee. Of those submissions 9 gave some consideration to preferences.

²⁵⁶ Ernst and Young

²⁵⁷ Wellington District Law Society

²⁵⁸ Coopers and Lybrand commented that this would ensure IRD acted promptly to recover any outstanding tax. Peat Marwicks and the New Zealand Society of Accountants (e.g., UK PAYE and VAT) also suggested time limits should be imposed on tax claims.

²⁵⁹ Coopers and Lybrand. The New Zealand Society of Accountants referred to the need for fees arising under the Radio Communications Act 1989 to be excluded and commented that there was "a need to resist the temptation to exceed the list of preferential claims to include fees associated with the business operations of government departments.

- the need for a statement that the seventh schedule was exhaustive²⁶⁰.

A further significant matter which was raised and, as previously indicated, needs to be "earmarked" for further consideration was the fact that clause 9(b) (Section 308(4)(b) equivalent) appeared to be unwarrantably punitive of floating charge holders²⁶¹.

What other general longer term action is needed to make preference law more soundly based?

While the select committee submissions have identified some of the longer term action required to improve the present regime the suggestions, apart from perhaps the New Zealand Law Society submissions, by and large represent "proposed tinkering" with the system. As stated previously, on a number of occasions, there needs to be a review of preferences in the context of general economic and social policy.

In general terms such a review would be able to address

²⁶⁰ The Society of Accountants and Cooper and Lybrand. Presumably for fear that the and/or practice of involving preferences via "outside" statutes might be resurrected existing statutory provisions involving preferences may have been overlooked.

In addition one submission suggested that the existing preference provisions were not comprehensive enough, that they arbitrarily favoured some claimants over others e.g., restitution claimants and consumers who pay in advance for goods and services by ticket or mail order should be included

Peter Watts

²⁶¹ Above n260. Peter Watts' view was that the current regime and the seventh schedule unfairly discriminated against floating charge holders and that all secured creditors should lose the same percentage of their security.

the general issues of whether or not there should be a preference regime and if so whether/how it should be changed. The advantages and disadvantages of all options including the options provided by overseas jurisdictions would necessarily be covered.

Do the recently proposed amendments to the Australian regime provide solutions?

One of the stated aims of the recent Australian Corporations Bill 1992 is to address proposals for corporate law reform outlined in the Harmer report²⁶². While the Bill has adopted the Harmer reports' recommendation that the priority given to costs of an ASC investigation should be abolished, and introduced a "priority list" to the various costs charges and expenses of a winding up²⁶³ it is notable that no amendment to the priorities to taxes has been made. In the "summary of the main features of the Bill"²⁶⁴ it is merely stated that "the question of special priorities accorded to the Commissioner of Taxation is still under consideration".²⁶⁵

Although a delay in this matter is not of course conclusive that the Harmer reports' recommendations that tax priorities should be abolished will not be adopted it

²⁶² Australian Law Reform Commission "General Insolvency Inquiry" (Report No 45). Other reports involved are the report by the Senate Standing Committee on constitutional and legal affairs entitled "The Social and Fiduciary Duties and Obligations of Company Directors"; and the Report by the Companies and Securities Advisory Committee on "Corporate Financial Transactions".

²⁶³ Clause H556 implements the Harmer reports proposed priority ranking of costs, charges and expenses of administration.

²⁶⁴ pp9 - 22 of the Draft Legislation and Explanatory Paper.

²⁶⁵ Above n265, p 16.

could represent an acknowledgement by the government that such as amendment would have unacceptable implications for the governments' "coffers". Other general comments that can be made about the scope of the amendments are:-

- (i) that generally the amendments are "technical" and not philosophical considerations. Many of the amendments are aimed at defining what debts should be included in what order in the specific winding up circumstances.²⁶⁶

While I am aware of the fact that there will always be difficulty in legislating for every conceivable possibility and yet on the other hand if there are to be clear priorities clear guidelines are needed.

- (ii) some amendments appear to highlight and propose to rectify the apparent unfairness that can occur as a consequence of any priority system necessarily involving line drawing and adhoc decisions.

For example, the amendment to give superannuation entitlements the same special priority as unpaid wages was introduced so that an employee who had "foregone wage increases in exchange for enhanced superannuation contributions by his or her employer" would not

²⁶⁶ e.g., in addition to the priority list of costs, charges and expenses of winding up special provisions are made via 556(1)(b) (c) and (d) for specified costs, expenses and debts in a Part 5.4 or 5.4A winding up or where a company has been under administration; proposed subsections (1)(d) to (dd) deal with specific priority orders.

be disadvantaged in a winding up²⁶⁷. Similarly, amendments to the provisions dealing with "excluded employees" (a present or recent director, a spouse of such a director or a relative of such a director) are intended to alleviate apparent injustices identified by the Harmer report.²⁶⁸

Other Possible Changes

While I am reluctant to comment on possible new directions for preferences, in view of the need for fundamental questioning of such a regime and the individual preferences, there are a number of areas in the United Kingdom, Australian and United States regimes which could be explored if it is decided to continue with preferences e.g.,

- given that preferences for outstanding wages and holiday pay exist, to varying degrees, in all jurisdictions it is arguable that some preference should be retained. Similarly it also seems arguable that redundancy pay or a similar scheme to that provided by, the United Kingdom employment protection fund and proposed

²⁶⁷ Paragraphs 1080 and 1081 p 552 Draft legislation and explanatory paper.

²⁶⁸ Above n267 pp 553 - 554 The Harmer Report recommended

" that a defacto spouse of a director of the company came within the definition of excluded employee; and
 . that it be made clear in the legislation that the limits applying to the debts which may be paid in priority to excluded employees (presently listed paragraphs 556(1)(e) to (g) only apply in relation to the amount of the debt which arose during the period in which the person was an excluded employee".

by the Harmer report re Wage Earner Protection Fund providing for redundancy pay should be included.

- as with outstanding wages and holiday pay, the existence of tax preferences in other regimes suggests such preferences should be retained. While it is arguable, on the basis of overseas examples, that the categories of tax preferences should be extended (e.g., to include income tax) on similar grounds it is arguable that if preferences are to continue then there should be a time limit placed on the period for which the Revenue can claim. Alternatively, taxes could be treated as a secured, rather than unsecured, debt.
- there should be a differentiation between employees generally and directors, directors' spouses and relatives of employees.²⁶⁹
- the adoption of a ranking system for priorities, rather than an equal ranking, would enable "more deserving" priorities (as assessed by the government/community) to be met.
- eliminating, in whole or in part, the present "discrimination" which occurs between floating

²⁶⁹

The Harmer report recommended amendments to the existing provisions relating to "excluded employees".

"While there is a justification for monitoring a class of excluded employees, the current provision (s 441(2)) should be amended to make clear that the exclusion from priority applying to an excluded employee should only relate to the claims of that employee for the period that the person is regarded as an excluded employee. A defacto spouse should be included in the definition of excluded employee [para 732]".

charge holders compared with fixed charge holders and preferential creditors. Possible options would be to have floating charge holders treated exactly the same as fixed charge holders, or to, only allow some preferential payments a priority over floating charge holders or to have floating charge holders ranking the same as fixed but requiring them to contribute a specified percentage of what they recoup to unsecured creditors²⁷⁰.

Existing "Statutory Preferences" Issues in New Zealand
When a company has gone into liquidation compared with
receivership, formal and informal arrangements and
Statutory Management Preference Regime.

The current law relating to priorities and preferential payments seems to be unnecessarily complex. This complexity is due to the dispersal of relevant provisions through a number of enactments, the main "preferential payments" provision not having a "self contained" list of debts to be given priority, and the fact that the precise nature of the regime varies according to whether the winding up is voluntary or by the court.

In essence the scheme for preferences is that costs and expenses incurred in any winding up are a "first call" on "free non encumbered assets" of the company. Next in priority are other specified unsecured creditors (wages, holiday pay (advances for some), PAYE, GST, Land Sales, and sums payable under the Voluntary Employment Protection Act, Apprenticeship Act, Accident Compensation Act and Motor Vehicle Dealers Act). To the extent that there are insufficient assets to meet these preferential claims floating charge holder assets are available.

²⁷⁰ As proposed by the Cork 10 percentum fund.

CONCLUSION

As indicated in the introduction the primary aim of this paper is to assess the present and proposed law on priorities with a view to indicating whether/what short and longer term amendments would be appropriate. In order to make such an assessment it is necessary to establish what the existing and proposed regimes in New Zealand and elsewhere are, and to consider what philosophical bases exist for those systems.

Existing "Statutory Preferences" regimes in New Zealand where a company has gone into liquidation compared with Receiverships, Formal and Informal Arrangements and Statutory Management preference regimes.

The current law relating to priorities and preferential payments seems to be unnecessarily complex. This complexity is due to the dispersal of relevant provisions through a number of enactments, the main "preferential payments" provision not having a "self contained" list of debts to be given priority, and the fact that the precise nature of the regime varies according to whether the winding up is voluntary or by the court.

In essence the scheme for preferences is that costs and expenses incurred in any winding up are a "first call" on "free non encumbered assets" of the company. Next in priority are other specified unsecured creditors (wages, holiday pay (advances for some) PAYE, GST, Layby Sales, and sums payable under the Volunteers Employment Protection Act, Apprenticeship Act, Accident Compensation Act and Motor Vehicle Dealers Act). To the extent that there are insufficient assets to meet these preferential claims floating charge holder assets are available.

The "intricacies" of the provisions have meant that case

law has focused on relatively fine terminology areas such as what constitutes a "cost, charge or expense" incurred in a winding up", what constitutes "assets of the company" and whether or not an individual is an employee who earned wages salary or holiday pay qualifying for priority.

While the priority provisions operating in Receiverships, Formal and Informal Arrangements and Statutory Management draw on similar bases to those of a company in liquidation there are differences in the regimes which tend to indicate a lack of philosophical consistency in the area of preferences generally and bring into question the appropriateness of specific priorities. Why, for instance, should the relevant time periods for calculating priority payments vary according to whether or not a receiver was appointed prior to a winding up order being made? Is it appropriate that schemes of arrangement can be adopted which are contrary to the statutory preference scheme? Why should priorities for the Volunteers' Employment Apprenticeship, Accident Compensation Corporation, Motor Vehicle Dealers Act be excluded from the Statutory Management context but continue in the liquidation and receivership areas?

In relation to availability of "litigation areas" between Statutory Preference regimes in Other jurisdictions (United Kingdom, Australia and the United States) where a company has gone into liquidation - Do they offer alternatives?

While there are clearly differences in general approach and specific priorities between the various regimes there is a degree of commonality in so far as preferences exist and have resulted in, amongst other things, a significant amount of litigation on relatively technical matters. In the United Kingdom, for instance, where the regime most closely resembles that of New Zealand, emphasis has again been placed on the need to clarify such matters as what

constitute costs and expenses of a winding up, what "assets" are available for distribution. Similarly, while the Australian regime varies from the others in so far as only wages, leave of absence and retrenchment payments receive a benefit over floating charge holders, case law has concentrated on issues such as what constitute "costs, charges and expenses" of a winding up and what assets are available for preferential payments?

Undoubtedly the United States system is the most unique and complex of those considered. It provides, for example, for a system of tax liens as well as unsecured tax priorities, for the subrogation of floating charge holders to other creditors via preferences and provides for non dischargeable debts. The reality of this complexity seems to be reflected in the fact that case law, in addition to dealing with areas common to the other jurisdictions, (whether specified items are costs and expenses of preserving assets, whether payments constitute salary or wages) covers virtually every priority area and is voluminous and very complex in areas such as taxation priorities and liens.

In addition to similarities of "litigation areas" between the various regimes indicating possible reform areas the extensiveness of case law in areas of difference could suggest that other jurisdictions do not offer appropriate alternatives.

The Philosophical bases for Preferences - They do not provide strong bases for continuing with preferences at a general or specific level.

While the concept of preferences may have had an acceptable philosophical basis when they were introduced to the United Kingdom in 1988 it is difficult to find that all of the somewhat "ad hoc" list presently existing in New

Zealand has such a solid basis. Such preferences do not appear to be justified on either "fairness and equity"/"general public acceptance" grounds (as measured by the government's current economic and social policies) on general "principles of insolvency law" bases, on economic risk bases or on indirect economic cost bases.

It seems clear that the concept of preferences is contrary to the government's objective of creating "a competitive enterprise economy" which emphasises the need for individual self reliance. Similarly the government's commitment to "fair and affordable social policies", based on individual self reliance, is generally contrary to the concept of priorities.

While there may be some scope for arguing that the government's targeting of "deserving social groups" justifies preferences it is unlikely that such an argument can be sustained given that it is also generally accepted that "social" and "economic" needs should be clearly separated. In any case the targeting of preference groups by "class" rather than "income levels" appears to be contrary to the general social philosophy.

In addition it is clear that preferences have direct, although unquantified, economic implications in so far as financing methods are altered to accommodate them and indirect economic implications in that complex preference regimes add to "administration" costs.

At a specific level it can probably be argued that the payment of revenue preferences are consistent with general Insolvency Philosophies and a "free market" economic philosophy in so far as it is the "community purse", rather than individual creditors, that benefit from such preferences. It seems however that many of the other preferences are antiquated or cannot be sufficiently

distinguished from other unsecured debts, so as to warrant a priority (at least on "rational consistency" grounds).

Further, while it appears that the different treatments of floating charge holders compared with fixed charge holders is probably justified, on the basis of the unusual position a floating charge holder has in respect of debtor financing, there is no quantitative data to support this conclusion.

Given the important implications of the distinctions it consequently seems to be imperative that an informed decision, (based on an analysis of relevant data), as to whether or not the distinction should continue, is made. Any consideration of this matter will necessarily need to have regard to the proposed Personal Property Securities Act which appears to provide some scope for continuing the present distinction between fixed and floating charge holders.

Proposed Reforms - While the amendments to the Companies Act will resolve some identified structural problems a broader longer term Review is required

As indicated in the discussion at pages one hundred and one to one hundred and ten above the reforms proposed by the Companies and Companies (Ancillary Provision) Bills will assist considerably in making the law more precise and accessible. It is clear, however, that the proposals do not go far enough. What is needed is a fundamental review of preferences, in the context of general economic and social policy drawing on appropriate statistical data, which addresses the issue of whether or not a preference regime can be justified?

If it is decided that there is a rational basis for a priorities scheme then the issues of what creditors should

be given a priority and how this should occur can be addressed. Undoubtedly other jurisdictions' experiences will be useful, although as is always the case both the advantages and disadvantages of those regimes, bearing in mind the New Zealand environment, need to be taken into account - It seems doubtful, for instance, whether a tax base the size of New Zealand's could afford to dispense with revenue priorities. On the other hand one also has to question whether the complexities of the United States revenue related regime, with its associated direct and indirect "administrative" costs, could be justified on any "increased return to revenue" or efficiency grounds.

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SECTION 308 PREFERENTIAL PAYMENTS

308(1) [Priorities] In a winding up there shall be paid in priority to all other debts—

- (a) All wages or salary of any employee, whether or not earned wholly or in part by way of commission, and whether payable for time or for piece work, in respect of services rendered to the company during 4 months next before the relevant date:
- (b) All holiday pay becoming payable to any employee (or in the case of his death to any other person in his right) on the termination of his employment before or by the effect of the winding-up order or resolution:
- (c) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, or unless the company has at the commencement of the winding up under such a contract of insurance as is mentioned in section 9 of the Law Reform Act 1936 rights capable of being transferred to and vested in the employee, all amounts due in respect of any compensation or liability for compensation under the Workers' Compensation Act 1956 accrued before the relevant date:
- (ca) All amounts deducted by the company from the wages or salary of any employee in order to satisfy obligations of the employee:
- (d) All sums required by section 326A of this Act or any other enactment to be included among the debts which are to be paid in priority to all other debts in the winding up.

History

S. 308(1) amended by No. 43 of 1980, s. 23(1), (2), (6), which; (i) added subs. (ca); (ii) inserted at (d) the words "section 326A of this Act or" after "required by" and; (iii) substituted "employee" for the words "servant or worker" and "worker".

308(2) [Limitation on priority] Notwithstanding subsection (1) of this section, the total sum to which priority is to be given under any of paragraphs (a), (b), and (ca) of that subsection shall not, in the case of any one employee, exceed [\$6,000] or such greater amount as is from time to time prescribed by the Governor-General by Order in Council.

[CH note: the amount stipulated in s 308(2) was effectively increased from \$2,000 to \$6,000 by SR 1988/198, effective 10 October 1988.]

History

S. 308(2) substituted by No. 43 of 1980, s. 23(3). Former s. 308(2) read as follows: "(2) Notwithstanding anything in paragraphs (a) and (b) of subsection (1) of this section, the sum to which priority is to be given under those paragraphs shall not, in the case of any one claimant, exceed \$1,500 or such greater amount as is from time to time prescribed by the Governor-General by Order in Council."

308(3) [Right of priority] Where any payment has been made—

- (a) To any employee in the employment of a company, on account of wages or salary; or
- (b) To any such employee or, in the case of his death, to any other person in his right, on account of holiday pay,—

out of money advanced by some person for that purpose, the person by whom the money was advanced shall in a winding up have a right of priority in respect of the

money so advanced and paid up to the amount by which the sum in respect of which the employee would have been entitled to priority in the winding up has been diminished by reason of the payment having been made.

History

S. 308(3) amended by No. 43 of 1980, s. 23(6), which substituted "employee" for the words "servant or worker" and "worker".

308(4) [Rank and priority] The foregoing debts shall—

- (a) Rank equally among themselves and be paid in full, unless the assets are insufficient to meet them, in which case they shall abate in equal proportions; and
- (b) So far as the assets of the company available for payment of general creditors are insufficient to meet them, have priority over the claims of holders of debentures under any floating charge created by the company, and be paid accordingly out of any property comprised in or subject to that charge.

308(5) [Discharge of debts] Subject to the retention of such sums as may be necessary for the costs and expenses of the winding up, the foregoing debts shall be discharged forthwith so far as the assets are sufficient to meet them.

308(6) [Charge on distrained goods] In the event of a landlord or other person distraining or having distrained on any goods or effects of the company within one month next before the date of a winding-up order, the debts to which priority is given by this section shall be a first charge on the goods or effects so distrained on, or the proceeds of the sale thereof:

Provided that, in respect of any money paid under any such charge, the landlord or other person shall have the same rights of priority as the person to whom the payment is made.

308(7) [Definitions] For the purposes of this section—

- (a) Any remuneration in respect of a period of holiday or of absence from work through sickness or other good cause shall be deemed to be wages in respect of services rendered to the company during that period:
- (b) The expression "holiday pay", in relation to any person, means all sums payable to him by the company under sections 11 to 23 of the Holidays Act 1981, and includes all sums which by or under any other enactment or any award, agreement, or contract of service are payable to him by the company as holiday pay:
- (c) The expression "the relevant date" means—
 - (i) In the case of a company ordered to be wound up compulsorily, the date of the appointment (or first appointment) of a provisional liquidator, or, if no such appointment was made, the date of the winding-up order, unless in either case the company had commenced to be wound up voluntarily before that date; and
 - (ii) In any case where subparagraph (i) of this paragraph does not apply, means the date of the passing of the resolution for the winding up of the company.
- (d) The expression "floating charge" includes a charge that conferred a floating security at the time of its creation but has since become a fixed or specific charge.

History

S. 308(7)(b) amended by No. 15 of 1982, s. 36(2), which substituted "sections 11 to 23 of the *Holidays Act 1981*" for "the *Annual Holidays Act 1944*".
S. 308(7)(d) added by No. 43 of 1980, s. 23(4).

308(8) [Application of order] Where a greater amount is prescribed by Order in Council for the purposes of subsection (2) of this section, the greater amount shall not apply—

- (a) In the case of a winding up, if the relevant date (as defined in subsection (7)(c) of this section) occurred before the commencement of the order; or
- (b) In the case of any matter to which section 101 of this Act applies, if the date referred to in subsection (3) of that section occurred before the commencement of the order.

As to compensation for personal injury, see now the *Accident Compensation Act 1972*, reprinted 1975, Vol 2.

As to the application of this section when a receiver is appointed or possession is taken under debentures secured by a floating charge, see s 101.

For other preferential claims, see s 23 of the *Apprenticeship Act 1983*; s 365 of the *Income Tax Act 1976*; s 11(2)(a) and (b) of the *Layby Sales Act 1971*; s 15(1)(b) of the *Volunteers Employment Protection Act 1973*; s 45(4) of the *Sales Tax Act 1974*; s 13(4)(b) of the *Cornish Companies Management Act 1974*; s 112A(1) of the *Accident Compensation Act 1972*; and s 42(3) of the *Motor Vehicle Dealers Act 1975*.

History

S. 308(8) substituted by No. 43 of 1980, s. 23(5). Former s. 308(8) read as follows:

"(8) This section shall not apply in the case of a winding up where the relevant date as defined in subsection (7) of

section 258 of the Companies Act 1933 occurred before the commencement of this Act, and in such a case the provisions relating to preferential payment which would have applied if this Act had not passed shall be deemed to remain in full force."

168. **Costs payable out of the assets**—(1) The assets of a company in a winding up by the Court remaining after payment of the fees and expenses properly incurred in preserving, realising, or getting in the assets, including where the company has previously commenced to be wound up voluntarily such remuneration, costs, and expenses as the Court may allow to a liquidator appointed in the voluntary winding up shall, subject to any order of the Court, be liable to the following payments, which shall be made in the following order of priority, namely:

First—The taxed costs of the petition, including the taxed costs of any person appearing on the petition whose costs are allowed by the Court:

Next—The remuneration of the special manager (if any):

Next—The costs and expenses of any person who makes or concurs in making the company's statement of affairs:

Next—The taxed charges of any shorthand writer appointed to take an examination:

Provided that where the shorthand writer is appointed at the instance of the Official Assignee the costs of the shorthand notes shall be deemed to be an expense incurred by the Official Assignee in getting in and realising the assets of the company:

Next—The necessary disbursements of any liquidator appointed in the winding up by the Court, other than expenses properly incurred in preserving, realising, or getting in the assets heretofore provided for:

Next—The costs of any person properly employed by any such liquidator:

Next—The remuneration of any such liquidator:

Next—The actual out-of-pocket expenses necessarily incurred by the committee of inspection, subject to the approval of the Audit Office.

(2) No payments in respect of bills of costs or charges of solicitors, managers, accountants, or other persons, other than payments for costs and expenses incurred and sanctioned under rule 37, and payments of bills which have been taxed and allowed under orders made for the taxation thereof, shall be allowed out of the assets of the company without proof that the same have been considered and allowed by the Registrar; and the Registrar shall before passing the bills of a solicitor satisfy himself that the appointment of a solicitor to assist the liquidator in the performance of his duties has been duly sanctioned:

Provided that the Official Assignee when acting as liquidator may without taxation pay and allow the costs and charges of any person employed by him where those costs and charges are within the scale usually allowed by the Court and do not exceed the sum of \$40:

Provided also that the Audit Office may require any such costs or charges to be taxed by the Registrar.

(3) Nothing contained in this rule shall apply to or affect costs which, in the course of legal proceedings by or against a company which is being wound up by the Court, are ordered by the Court in which the proceedings are pending or a Judge thereof to be paid by the company or the liquidator, or the rights of the person to whom any such costs are payable.

Schedule of elaborating provisions Section 261 of the Companies Act 1955

Relevant Provision	General content of provision
R.162 Application for costs	Where any party to, or person affected by, any proceeding desires to make an application for an order that he be allowed his costs, or any part of them, incident to the proceeding, and the application is not made at the time of the proceeding -
R.168 Costs payable out of the assets	(1) The assets of a company winding up by the court shall subject to any order of court, be liable to the following payments

Relevant Provision	General content of provision
<p>R.52 Shorthand notes.</p> <p>R.138 Remuneration of liquidator</p>	<p style="text-align: center;"><u>Witnesses and Depositions</u></p> <p><u>52 Shorthand notes</u></p> <p>(1) If the court or the person before whom any examination under the Act and rules is directed to be held shall be of opinion that it would be desirable that a person should be appointed to take down the evidence</p> <p>(3) those sums shall be paid by the party at whose instance the appointment was made, or out of the assets of the company, as may be directed by court.</p> <p>(1) The remuneration of a liquidator, unless the court shall otherwise order, shall be fixed by the committee of inspection, and shall be in the nature of a commission or percentage on the amount on which the fee payable to the Public Account would have been computed if the Official Assignee had been the liquidator.</p> <p>(2)</p> <p>(3) If there is no committee of inspection unless the court shall otherwise order be fixed by the scale of fees for the time being payable to the Public Account in respect of the services of the Official Assignee as liquidator.</p> <p>(4) only apply in a winding up by the court.</p>

Schedule of elaborating provisions Rule 168 of the Companies (Winding up) Rules 1956

Relevant Provision	General content of provision
Section 231 Statement of Company's Affairs to be submitted to Official Assignee	(4) Any person making or concurring in making shall be paid by the Official Assignee or provisional liquidator such costs and expenses as the Official Assignee may consider reasonable, subject to an appeal to the court.
Section 237 General provisions as to liquidators	(2) Remuneration - where a person other than the Official Assignee is appointed liquidator he shall receive such salary or remuneration by way of percentage or otherwise as the court may direct,
Section 257 Appointment of Special Manager	(3) The special manager shall receive such remuneration as may be fixed by the court.
Section 287 Fixing of liquidators' Remuneration and lesser of	(1) The committee of inspection or, if there is no such committee, the creditors, may fix the remuneration to be paid to the liquidator or liquidators. (2)

Taxation of costs

R.158 Taxation of costs payable
by or to the Official
Assignee or liquidator

Every solicitor, manager, accountant, or other person employed by an Official Assignee or liquidator in a winding up by the court shall on request deliver his bill of costs or charges for the purpose of taxation, and if he fails to do so within the liquidator shall declare and distribute the dividend

R.159 Lodgement of Bill

R.160 Notice of appointment

R.161 Copy of the bill to be
furnished.

R.163 Certificate of Taxation

R.164 Certificate of Employment

R.165 Sheriff's costs

R.166 Taxation of sheriff's costs
after deduction

R.167 Liquidator's charges

(1) Where a liquidator or special manager in a winding up by the court receives remuneration for his services as such, no payment shall be allowed on his accounts in respect of the performance by any other person of the ordinary duties which are required by statute or rules to be performed by himself.

(2) Where a liquidator is a solicitor he may contract that the remuneration for his services as liquidator shall include all professional services.

Relevant Provisions	General content of provision
R.31 Appointment of Special Manager	<p>(1)</p> <p>(2) The remuneration of the special manager shall, unless the court otherwise in any case directs, be stated in the order appointing him, but the court may at any subsequent time for good cause shown make an order for payment to the special manager of further remuneration</p>
R.37 Expenses of Statement of Affairs	<p>A person who is required to make or concur in making any statement of affairs of a company shall, before incurring any costs or expenses apply to the Official Assignee for his sanction and submit a statement of the estimated costs and expenses which it is intended to incur; and, except by order of the court no person shall be allowed any costs or expenses which have not before being incurred been sanctioned by the Official Assignee.</p>
R.40 Standing security	<p>(d) The cost of furnishing the required security by a liquidator shall not be charged against the assets of the company as an expense in the winding up.</p>

Relevant Provisions	General content of provision
R.31 Appointment of Special Manager	<p>(1)</p> <p>(2) The remuneration of the special manager shall, unless the court otherwise in any case directs, be stated in the order appointing him, but the court may at any subsequent time for good cause shown make an order for payment to the special manager of further remuneration</p>
R.37 Expenses of Statement of Affairs	<p>A person who is required to make or concur in making any statement of affairs of a company shall, before incurring any costs or expenses apply to the Official Assignee for his sanction and submit a statement of the estimated costs and expenses which it is intended to incur; and, except by order of the court no person shall be allowed any costs or expenses which have not before being incurred seen sanctioned by the Official Assignee.</p>
R.40 Standing security	<p>(d) The cost of furnishing the required security by a liquidator shall not be charged against the assets of the company as an expense in the winding up.</p>

Schedule 6 — The Categories of Preferential Debts

Section 386

CATEGORY 1: DEBTS DUE TO INLAND REVENUE

1 Sums due at the relevant date from the debtor on account of deductions of income tax from emoluments paid during the period of 12 months next before that date.

The deductions here referred to are those which the debtor was liable to make under section 203 of the Income and Corporation Taxes Act 1988 (pay as you earn), less the amount of the repayments of income tax which the debtor was liable to make during that period.

History

In para. 1 the words "203 of the Income and Corporation Taxes Act 1988" substituted for the former words "204 of the Income and Corporation Taxes Act 1970" by Income

and Corporation Taxes Act 1988, s. 844 and Sch. 29, para. 32 for companies' accounting periods ending after 5 April 1988 (see s. 843(1)).

2 Sums due at the relevant date from the debtor in respect of such deductions as are required to be made by the debtor for that period under section 559 of the Income and Corporation Taxes Act 1988 (sub-contractors in the construction industry).

History

In para. 2 the words "559 of the Income and Corporation Taxes Act 1988" substituted for the former words "69 of the Finance (No. 2) Act 1975" by Income and Corporation

Taxes Act 1988, s. 844 and Sch. 29, para. 32 for companies' accounting periods ending after 5 April 1988 (see s. 843(1)).

CATEGORY 2: DEBTS DUE TO CUSTOMS AND EXCISE

3 Any value added tax which is referable to the period of 6 months next before the relevant date (which period is referred to below as "the 6-month period").

For the purposes of this paragraph—

(a) where the whole of the prescribed accounting period to which any value added tax is attributable falls within the 6-month period, the whole amount of that tax is referable to that period; and

(b) in any other case the amount of any value added tax which is referable to the 6-month period is the proportion of the tax which is equal to such proportion (if any) of the accounting reference period in question as falls within the 6-month period;

and in sub-paragraph (a) "prescribed" means prescribed by regulations under the Value Added Tax Act 1983.

4 The amount of any car tax which is due at the relevant date from the debtor and which became due within a period of 12 months next before that date.

5 Any amount which is due—

(a) by way of general betting duty or bingo duty, or

(b) under section 12(1) of the Betting and Gaming Duties Act 1981 (general betting duty and pool betting duty recoverable from agent collecting stakes), or

(c) under section 14 of, or Schedule 2 to, that Act (gaming licence duty),

from the debtor at the relevant date and which became due within the period of 12 months next before that date.

Note

Prospective insertion of new para. 5A by Finance Act 1991, s. 7 and Sch. 2, para. 22:

"5A The amount of any excise duty on beer which is due at the relevant date from the debtor and which became due within a period of 6 months next before that date."

CATEGORY 3: SOCIAL SECURITY CONTRIBUTIONS

6 All sums which on the relevant date are due from the debtor on account of Class 1 or Class 2 contributions under the Social Security Act 1975 or the Social Security (Northern Ireland) Act 1975 and which became due from the debtor in the 12 months next before the relevant date.

7 All sums which on the relevant date have been assessed on and are due from the debtor on account of Class 4 contributions under either of those Acts of 1975, being sums which—

(a) are due to the Commissioners of Inland Revenue (rather than to the Secretary of State or a Northern Ireland department), and

(b) are assessed on the debtor up to 5th April next before the relevant date,

but not exceeding, in the whole, any one year's assessment.

CATEGORY 4: CONTRIBUTIONS TO OCCUPATIONAL PENSION SCHEMES, ETC.

8 Any sum which is owed by the debtor and is a sum to which Schedule 3 to the Social Security Pensions Act 1975 applies (contributions to occupational pension schemes and state scheme premiums).

CATEGORY 5: REMUNERATION, ETC., OF EMPLOYEES

9 So much of any amount which—

(a) is owed by the debtor to a person who is or has been an employee of the debtor, and

- (b) is payable by way of remuneration in respect of the whole or any part of the period of 4 months next before the relevant date,

as does not exceed so much as may be prescribed by order made by the Secretary of State.

Note
See Note after para. 12.

10 An amount owed by way of accrued holiday remuneration, in respect of any period of employment before the relevant date, to a person whose employment by the debtor has been terminated, whether before, on or after that date.

11 So much of any sum owed in respect of money advanced for the purpose as has been applied for the payment of a debt which, if it had not been paid, would have been a debt falling within paragraph 9 or 10.

12 So much of any amount which—

(a) is ordered (whether before or after the relevant date) to be paid by the debtor under the Reserve Forces (Safeguard of Employment) Act 1985, and

(b) is so ordered in respect of a default made by the debtor before that date in the discharge of his obligations under that Act.

as does not exceed such amount as may be prescribed by order made by the Secretary of State.

Note
The amount for para. 9, 12 is £800 — see The Insolvency Proceedings (Monetary Limits) Order 1986 (S.I. 1986 No. 1996), art. 4.

INTERPRETATION FOR CATEGORY 5

13(1) For the purposes of paragraphs 9 to 12, a sum is payable by the debtor to a person by way of remuneration in respect of any period if—

(a) it is paid as wages or salary (whether payable for time or for piece work or earned wholly or partly by way of commission) in respect of services rendered to the debtor in that period, or

(b) it is an amount falling within the following sub-paragraph and is payable by the debtor in respect of that period.

13(2) An amount falls within this sub-paragraph if it is—

(a) a guarantee payment under section 12(1) of the Employment Protection (Consolidation) Act 1978 (employee without work to do for a day or part of a day);

(b) remuneration on suspension on medical grounds under section 19 of that Act;

(c) any payment for time off under section 27(3) (trade union duties), 31(3) (looking for work, etc.) or 31A(4) (ante-natal care) of that Act; or

(d) remuneration under a protective award made by an industrial tribunal under section 101 of the Employment Protection Act 1975 (redundancy dismissal with compensation).

14(1) This paragraph relates to a case in which a person's employment has been terminated by or in consequence of his employer going into liquidation or being adjudged bankrupt or (his employer being a company not in liquidation) by or in consequence of—

(a) a receiver being appointed as mentioned in section 40 of this Act (debenture-holders secured by floating charge), or

(b) the appointment of a receiver under section 53(6) or 54(5) of this Act (Scottish company with property subject to floating charge), or

(c) the taking of possession by debenture-holders (so secured), as mentioned in section 196 of the Companies Act.

14(2) For the purposes of paragraphs 9 to 12, holiday remuneration is deemed to have accrued to that person in respect of any period of employment if, by virtue of his contract of employment or of any enactment, that remuneration would have accrued in respect of that period if his employment had continued until he became entitled to be allowed the holiday.

14(3) The reference in sub-paragraph (2) to any enactment includes an order or direction made under an enactment.

15 Without prejudice to paragraphs 13 and 14—

- (a) any remuneration payable by the debtor to a person in respect of a period of holiday or of absence from work through sickness or other good cause is deemed to be wages or (as the case may be) salary in respect of services rendered to the debtor in that period, and
- (b) references here and in those paragraphs to remuneration in respect of a period of holiday include any sums which, if they had been paid, would have been treated for the purposes of the enactments relating to social security as earnings in respect of that period.

CATEGORY 6: LEVIES ON COAL AND STEEL PRODUCTION

15A Any sums due at the relevant date from the debtor in respect of—

- (a) the levies on the production of coal and steel referred to in Article 49 and 50 of the E.C.S.C. Treaty, or
- (b) any surcharge for delay provided for in Article 50(3) of that Treaty and Article 6 of Decision 3/52 of the High Authority of the Coal and Steel Community.

History

Para. 15A inserted by The Insolvency (ECSC Levy Debts) Regulations 1987 (S.I. 1987 No. 2093), reg. 2(1) as from 1 January 1988.

Note

See The Insolvency (ECSC Levy Debts) Regulations 1987 (S.I. 1987 No. 2093), reg. 2(3) and 4 concerning the relevant date and preferential treatment under former law.

ORDERS

16 An order under paragraph 9 or 12—

- (a) may contain such transitional provisions as may appear to the Secretary of State necessary or expedient;
- (b) shall be made by statutory instrument subject to annulment in pursuance of a resolution of either House of Parliament.

New Zealand

SECTION 308 PREFERENTIAL PAYMENTS

308(1) [Priorities] In a winding up there shall be paid in priority to all other debts—

- (a) All wages or salary of any employee, whether or not earned wholly or in part by way of commission, and whether payable for time or for piece work, in respect of services rendered to the company during 4 months next before the relevant date;
- (b) All holiday pay becoming payable to any employee (or in the case of his death to any other person in his right) on the termination of his employment before or by the effect of the winding-up order or resolution;
- (c) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, or unless the company has at the commencement of the winding up under such a contract of insurance as is mentioned in section 9 of the Law Reform Act 1936 rights capable of being transferred to and vested in the employee, all amounts due in respect of any compensation or liability for compensation under the Workers' Compensation Act 1956 accrued before the relevant date;
- (ca) All amounts deducted by the company from the wages or salary of any employee in order to satisfy obligations of the employee:
e.g., Family Support Act 1992
- (d) All sums required by section 326A of this Act or any other enactment to be included among the debts which are to be paid in priority to all other debts in the winding up.

[Section 326A No lien over company's books, records; \$500 priority if otherwise have lien]

- . Volunteers' Employment Protection Act 1973 (\$200)
- . Apprenticeship Act 1983 (3 months wages)
- . Accident Compensation Act 1982 (\$1,500)
- . Motor Vehicle Dealers Act 1975

Debts specified by statute as ranking immediately after preferential e.g.,

- . Tax Act 1976 (PAYE; not penalties)
- . GST Act 1985 (not penalties)
- . Layby Sales Act 1971

United Kingdom

Schedule 6 — The Categories of Preferential Debts

Section 386

CATEGORY 1: DEBTS DUE TO INLAND REVENUE

1 Sums due at the relevant date from the debtor on account of deductions of income tax from emoluments paid during the period of 12 months next before that date.

The deductions here referred to are those which the debtor was liable to make under section 203 of the Income and Corporation Taxes Act 1988 (pay as you earn), less the amount of the repayments of income tax which the debtor was liable to make during that period.

2 Sums due at the relevant date from the debtor in respect of such deductions as are required to be made by the debtor for that period under section 559 of the Income and Corporation Taxes Act 1988 (sub-contractors in the construction industry).

CATEGORY 2: DEBTS DUE TO CUSTOMS AND EXCISE

3 Any value added tax which is referable to the period of 6 months next before the relevant date (which period is referred to below as "the 6-month period").

For the purposes of this paragraph—

- (a) where the whole of the prescribed accounting period to which any value added tax is attributable falls within the 6 month period, the whole amount of that tax is referable to that period; and
- (b) in any other case the amount of any value added tax which is referable to the 6-month period is the proportion of the tax which is equal to such proportion (if any) of the accounting reference period in question as falls within the 6-month period;

and in sub-paragraph (a) "prescribed" means prescribed by regulations under the Value Added Tax Act 1983.

4 The amount of any car tax which is due at the relevant date from the debtor and which became due within a period of 12 months next before that date.

5 Any amount which is due—

- (a) by way of general betting duty or bingo duty, or
- (b) under section 12(1) of the Betting and Gaming Duties Act 1981 (general betting duty and pool betting duty recoverable from agent collecting stakes), or

(c) under section 14 of, or Schedule 2 to, that Act (gaming licence duty), from the debtor at the relevant date and which became due within the period of 12 months next before that date.

CATEGORY 3: SOCIAL SECURITY CONTRIBUTIONS

6 All sums which on the relevant date are due from the debtor on account of Class 1 or Class 2 contributions under the Social Security Act 1975 or the Social Security (Northern Ireland) Act 1975 and which became due from the debtor in the 12 months next before the relevant date.

7 All sums which on the relevant date have been assessed on and are due from the debtor on account of Class 4 contributions under either of those Acts of 1975, being sums which—

(a) are due to the Commissioners of Inland Revenue (rather than to the Secretary of State or a Northern Ireland department), and

(b) are assessed on the debtor up to 5th April next before the relevant date, but not exceeding, in the whole, any one year's assessment.

CATEGORY 4: CONTRIBUTIONS TO OCCUPATIONAL PENSION SCHEMES, ETC.

8 Any sum which is owed by the debtor and is a sum to which Schedule 3 to the Social Security Pensions Act 1975 applies (contributions to occupational pension schemes and state scheme premiums).

CATEGORY 5: REMUNERATION, ETC., OF EMPLOYEES

9 So much of any amount which—

(a) is owed by the debtor to a person who is or has been an employee of the debtor, and

(b) is payable by way of remuneration in respect of the whole or any part of the period of 4 months next before the relevant date,

as does not exceed so much as may be prescribed by order made by the Secretary of State.

10 An amount owed by way of accrued holiday remuneration, in respect of any period of employment before the relevant date, to a person whose employment by the debtor has been terminated, whether before, on or after that date.

11 So much of any sum owed in respect of money advanced for the purpose as has been applied for the payment of a debt which, if it had not been paid, would have been a debt falling within paragraph 9 or 10.

12 So much of any amount which—

(a) is ordered (whether before or after the relevant date) to be paid by the debtor under the Reserve Forces (Safeguard of Employment) Act 1985, and

(b) is so ordered in respect of a default made by the debtor before that date in the discharge of his obligations under that Act.

as does not exceed such amount as may be prescribed by order made by the Secretary of State.

15 Without prejudice to paragraphs 13 and 14—

- (a) any remuneration payable by the debtor to a person in respect of a period of holiday or of absence from work through sickness or other good cause is deemed to be wages or (as the case may be) salary in respect of services rendered to the debtor in that period, and
- (b) references here and in those paragraphs to remuneration in respect of a period of holiday include any sums which, if they had been paid, would have been treated for the purposes of the enactments relating to social security as earnings in respect of that period.

CATEGORY 6: LEVIES ON COAL AND STEEL PRODUCTION

15A Any sums due at the relevant date from the debtor in respect of—

- (a) the levies on the production of coal and steel referred to in Article 49 and 50 of the E.C.S.C. Treaty, or
- (b) any surcharge for delay provided for in Article 50(3) of that Treaty and Article 6 of Decision 3/52 of the High Authority of the Coal and Steel Community.

SECTION 556 PRIORITY PAYMENTS 441

556(1) [Priorities] Subject to the following provisions of this Division, in the winding up of a company the following debts shall be paid in priority to all other unsecured debts:

- (a) first, the costs, charges and expenses of the winding up, including the taxed costs of an applicant payable under section 466, the remuneration of the liquidator and the costs of any audit carried out under section 539;
- (b) if the winding up was preceded by the appointment of a provisional liquidator — next, the costs, charges and expenses properly and reasonably incurred by the provisional liquidator during the period of his or her appointment and the remuneration of the provisional liquidator;
- (c) where the winding up commences within 2 months after the end of a period of official management of the company — next, the costs, charges and expenses of and incidental to the official management properly and reasonably incurred by the official manager during the period of official management, including the remuneration of the official manager, of any deputy official manager and of any auditor appointed in accordance with Part 3.7;
- (d) where the winding up commences within 2 months after the end of a period of official management of the company — next, debts of the company properly and reasonably incurred by the official manager in the conduct by him or her of the business of the company during the period of official management;
- (e) next, wages in respect of services rendered to the company by employees before the relevant date, but not exceeding \$2,000 in respect of an excluded employee of the company;
- (f) next, all amounts due in respect of injury compensation, being compensation the liability for which arose before the relevant date;
- (g) next, all amounts due:
 - (i) on or before the relevant date;
 - (ii) by virtue of an industrial instrument;
 - (iii) to, or in respect of, employees of the company; and
 - (iv) in respect of leave of absence;
 but not exceeding \$1,500 in respect of an excluded employee of the company;
- (h) next, retrenchment payments payable to employees of the company (other than excluded employees of the company);
- (j) next, any amount that, pursuant to an order under section 91 of the ASC Law, the company was at the relevant date under an obligation to pay.

556(2) [Interpretation] In this section:

“company” means a company that is being wound up;

“employee”, in relation to a company, means a person:

- (a) who has been or is an employee of the company, whether remunerated by salary, wages, commission or otherwise; and
- (b) whose employment by the company commenced before the relevant date;

“excluded employee”, in relation to a company, means:

- (a) an employee of the company who has been:
 - (i) at any time during the period of 12 months ending on the relevant date;
 - or
 - (ii) at any time since the relevant date;
 or who is, a director of the company;
- (b) an employee of the company who has been:
 - (i) at any time during the period of 12 months ending on the relevant date;
 - or
 - (ii) at any time since the relevant date;
 or who is, the spouse of an employee of the kind referred to in paragraph (a);
 or

- (c) an employee of the company who is a relative (other than a spouse) of an employee of the kind referred to in paragraph (a);

“retrenchment payment”, in relation to an employee of a company, means an amount payable by the company to the employee, by virtue of an industrial instrument, in respect of the termination of the employee’s employment by the company, whether the amount becomes payable before, on or after the relevant date.

New Zealand

SECTION 308 PREFERENTIAL PAYMENTS

308(1) [Priorities] In a winding up there shall be paid in priority to all other debts—

- (a) All wages or salary of any employee, whether or not earned wholly or in part by way of commission, and whether payable for time or for piece work, in respect of services rendered to the company during 4 months next before the relevant date;
 - (b) All holiday pay becoming payable to any employee (or in the case of his death to any other person in his right) on the termination of his employment before or by the effect of the winding-up order or resolution;
 - (c) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, or unless the company has at the commencement of the winding up under such a contract of insurance as is mentioned in section 9 of the Law Reform Act 1936 rights capable of being transferred to and vested in the employee, all amounts due in respect of any compensation or liability for compensation under the Workers' Compensation Act 1956 accrued before the relevant date;
 - (ca) All amounts deducted by the company from the wages or salary of any employee in order to satisfy obligations of the employee:
- e.g., Family Support Act 1992
- (d) All sums required by section 326A of this Act or any other enactment to be included among the debts which are to be paid in priority to all other debts in the winding up.

[Section 326A No lien over company's books, records; \$500 priority if otherwise have lien]

- . Volunteers' Employment Protection Act 1973 (\$200)
- . Apprenticeship Act 1983 (3 months wages)
- . Accident Compensation Act 1982 (\$1,500)
- . Motor Vehicle Dealers Act 1975

Debts specified by statute as ranking immediately after preferential e.g.,

- . Income Tax Act 1976 (PAYE; not penalties)
- . GST Act 1985 (not penalties)
- . Layby Sales Act 1971

Australia

SECTION 556 PRIORITY PAYMENTS 441

556(1) [Priorities] Subject to the following provisions of this Division, in the winding up of a company the following debts shall be paid in priority to all other unsecured debts:

- (a) first, the costs, charges and expenses of the winding up, including the taxed costs of an applicant payable under section 466, the remuneration of the liquidator and the costs of any audit carried out under section 539;
- (b) if the winding up was preceded by the appointment of a provisional liquidator next, the costs, charges and expenses properly and reasonably incurred by the provisional liquidator during the period of his or her appointment and the remuneration of the provisional liquidator;
- (c) where the winding up commences within 2 months after the end of a period of official management of the company — next, the costs, charges and expenses of and incidental to the official management properly and reasonably incurred by the official manager during the period of official management, including the remuneration of the official manager, of any deputy official manager and of any auditor appointed in accordance with Part 3.7;
- (d) where the winding up commences within 2 months after the end of a period of official management of the company — next, debts of the company properly and reasonably incurred by the official manager in the conduct by him or her of the business of the company during the period of official management;
- (e) next, wages in respect of services rendered to the company by employees before the relevant date, but not exceeding \$2,000 in respect of an excluded employee of the company;
- (f) next, all amounts due in respect of injury compensation, being compensation the liability for which arose before the relevant date;
- (g) next, all amounts due:
 - (i) on or before the relevant date;
 - (ii) by virtue of an industrial instrument;
 - (iii) to, or in respect of, employees of the company; and
 - (iv) in respect of leave of absence;but not exceeding \$1,500 in respect of an excluded employee of the company;
- (h) next, retrenchment payments payable to employees of the company (other than excluded employees of the company);

- (j) next, any amount that, pursuant to an order under section 91 of the ASC Law, the company was at the relevant date under an obligation to pay.

556(2) [Interpretation] In this section:

“company” means a company that is being wound up;

“employee”, in relation to a company, means a person:

- (a) who has been or is an employee of the company, whether remunerated by salary, wages, commission or otherwise; and
- (b) whose employment by the company commenced before the relevant date;

“excluded employee”, in relation to a company, means:

- (a) an employee of the company who has been:
 - (i) at any time during the period of 12 months ending on the relevant date;
or
 - (ii) at any time since the relevant date;or who is, a director of the company;
- (b) an employee of the company who has been:
 - (i) at any time during the period of 12 months ending on the relevant date;
or
 - (ii) at any time since the relevant date;or who is, the spouse of an employee of the kind referred to in paragraph (a);
or
- (c) an employee of the company who is a relative (other than a spouse) of an employee of the kind referred to in paragraph (a);

“retrenchment payment”, in relation to an employee of a company, means an amount payable by the company to the employee, by virtue of an industrial instrument, in respect of the termination of the employee’s employment by the company, whether the amount becomes payable before, on or after the relevant date.

§ 507. Priorities

(a) The following expenses and claims have priority in the following order:

(1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

(2) Second, unsecured claims allowed under section 502(f) of this title.

(3) Third, allowed unsecured claims for wages, salaries, or commissions, including vacation, severance and sick leave pay—

(A) earned by an individual within 90 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only

(B) to the extent of \$2,000 for each such individual.

(4) Fourth, allowed unsecured claims for contributions to employee benefit plans—

(A) arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only

(B) for each such plan, to the extent of—

(i) the number of employees covered by such plan multiplied by \$2,000; less

(ii) the aggregate amount paid to such employees under paragraph (3) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan.

(5) Fifth, allowed unsecured claims of individuals, to the extent of \$900 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.

(6) Sixth, allowed unsecured claims of governmental units, to the extent that such claims are for—

(A) a tax on or measured by income or gross receipts—

(i) for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or

(iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

(B) a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (3) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

(F) a customs duty arising out of the importation of merchandise—

(i) entered for consumption within one year before the date of the filing of the petition;

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisement or classification of such merchandise was not available to the appropriate customs officer before such date; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

(b) If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

(c) For the purpose of subsection (a) of this section, a claim of a governmental unit arising from an erroneous refund or credit of a tax shall be treated the same as a claim for the tax to which such refund or credit relates.

(d) An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection (a)(3), (a)(4), (a)(5), or (a)(6) of this section is not subrogated to the right of the holder of such claim to priority under such subsection.

Pub.L. 95-598, Nov. 6, 1978, 92 Stat. 2583.

New Zealand

SECTION 308 PREFERENTIAL PAYMENTS

308(1) [Priorities] In a winding up there shall be paid in priority to all other debts—

- (a) All wages or salary of any employee, whether or not earned wholly or in part by way of commission, and whether payable for time or for piece work, in respect of services rendered to the company during 4 months next before the relevant date;
- (b) All holiday pay becoming payable to any employee (or in the case of his death to any other person in his right) on the termination of his employment before or by the effect of the winding up order or resolution;
- (c) Unless the company is being wound up voluntarily merely for the purposes of reconstruction or of amalgamation with another company, or unless the company has at the commencement of the winding up under such a contract of insurance as is mentioned in section 9 of the Law Reform Act 1936 rights capable of being transferred to and vested in the employee, all amounts due in respect of any compensation or liability for compensation under the Workers' Compensation Act 1956 accrued before the relevant date;
- (ca) All amounts deducted by the company from the wages or salary of any employee in order to satisfy obligations of the employee:

e.g., Family Support Act 1992

- (d) All sums required by section 326A of this Act or any other enactment to be included among the debts which are to be paid in priority to all other debts in the winding up.

[Section 326A No lien over company's books, records; \$500 priority if otherwise have lien]

- . Volunteers' Employment Protection Act 1973 (\$200)
- . Apprenticeship Act 1983 (3 months wages)
- . Accident Compensation Act 1982 (\$1,500)
- . Motor Vehicle Dealers Act 1975

Debts specified by statute as ranking immediately after preferential e.g.,

- . Income Tax Act 1976 (PAYE; not penalties)
- . GST Act 1985 (not penalties)
- . Layby Sales Act 1971

United States

§ 507. Priorities

(a) The following expenses and claims have priority in the following order:

(1) First, administrative expenses allowed under section 503(b) of this title, and any fees and charges assessed against the estate under chapter 123 of title 28.

(2) Second, unsecured claims allowed under section 502(f) of this title.

(3) Third, allowed unsecured claims for wages, salaries, or commissions, including vacation, severance and sick leave pay—

(A) earned by an individual within 90 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only

(B) to the extent of \$2,000 for each such individual.

(4) Fourth, allowed unsecured claims for contributions to employee benefit plans—

(A) arising from services rendered within 180 days before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only

(B) for each such plan, to the extent of—

(i) the number of employees covered by such plan multiplied by \$2,000; less

(ii) the aggregate amount paid to such employees under paragraph (3) of this subsection, plus the aggregate amount paid by the estate on behalf of such employees to any other employee benefit plan.

(5) Fifth, allowed unsecured claims of individuals, to the extent of \$900 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.

(6) Sixth, allowed unsecured claims of governmental units, to the extent that such claims are for—

(A) a tax on or measured by income or gross receipts—

(i) for a taxable year ending on or before the date of the filing of the petition for which a return, if required, is last due, including extensions, after three years before the date of the filing of the petition;

(iii) entered for consumption within four years before the date of the filing of the petition but unliquidated on such date, if the Secretary of the Treasury certifies that failure to liquidate such entry was due to an investigation pending on such date into assessment of antidumping or countervailing duties or fraud, or if information needed for the proper appraisal or classification of such merchandise was not available to the appropriate customs officer before such date; or

(G) a penalty related to a claim of a kind specified in this paragraph and in compensation for actual pecuniary loss.

(b) If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection.

(c) For the purpose of subsection (a) of this section, a claim of a governmental unit arising from an erroneous refund or credit of a tax shall be treated the same as a claim for the tax to which such refund or credit relates.

(d) An entity that is subrogated to the rights of a holder of a claim of a kind specified in subsection (a)(3), (a)(4), (a)(5), or (a)(6) of this section is not subrogated to the right of the holder of such claim to priority under such subsection.

(ii) assessed within 240 days, plus any time plus 30 days during which an offer in compromise with respect to such tax that was made within 240 days after such assessment was pending, before the date of the filing of the petition; or

(iii) other than a tax of a kind specified in section 523(a)(1)(B) or 523(a)(1)(C) of this title, not assessed before, but assessable, under applicable law or by agreement, after, the commencement of the case;

(B) a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition;

(C) a tax required to be collected or withheld and for which the debtor is liable in whatever capacity;

(D) an employment tax on a wage, salary, or commission of a kind specified in paragraph (3) of this subsection earned from the debtor before the date of the filing of the petition, whether or not actually paid before such date, for which a return is last due, under applicable law or under any extension, after three years before the date of the filing of the petition;

(E) an excise tax on—

(i) a transaction occurring before the date of the filing of the petition for which a return, if required, is last due, under applicable law or under any extension, after three years before the date of the filing of the petition; or

(ii) if a return is not required, a transaction occurring during the three years immediately preceding the date of the filing of the petition;

(F) a customs duty arising out of the importation of merchandise—

(i) entered for consumption within one year before the date of the filing of the petition;

(ii) covered by an entry liquidated or reliquidated within one year before the date of the filing of the petition; or

Appendix IX
Relevant extracts, from the Corporations (Investigation and Management Act 1989.

Section 65 provides:-

"All costs, charges and expenses properly incurred by a statutory manager in the exercise of the manager's functions and powers under this Act (including such remuneration as may be approved by the Minister) shall be payable out of the property of the corporation in respect of which the statutory manager is appointed in priority to all other claims".

Section 51(2) states

"Where the statutory manager of a corporation sells or otherwise disposes of any property or assets of that corporation pursuant to Section 50(1) of this Act, being property or assets subject to a fixed charge in favour of any person, the person entitled to the charge shall be paid out of the proceeds of sale or other disposition in priority to all other claims other than the costs of the statutory manager in selling or disposing of the property or assets and claims in respect of preferential payments made under Section 308 of the Companies Act 1955 (as applied by Section 55 of this Act)".

Section 55 provides

"Sections 308 (except subsection (1)(d)), 309 to 311c and shall apply to a corporation that is subject to statutory management under this Act in all respects, and with such modifications as may be necessary, as if -

- (a) The corporation were a company that was being wound up under that Act; and

Extract from House of Representatives, July 1990.

(b) The statutory manager of the corporation were the liquidator of the company; and

(c) The date on which the corporation became subject to statutory management were the date of the commencement of the winding up." (emphasis added).

Extract from July 1990 Budget and Tables, House of Representatives, July 1990.

"In just six years we have:-

- . abolished foreign exchange controls;
- . floated the exchange rate;
- . freed up the labour and capital markets;
- . carried out extensive reforms to the tax system;
- . removed Government subsidies;
- . abolished import licensing and substantially reduced tariffs;
- . re-established Government trading departments in a corporate form as state-owned enterprises and used the proceeds to reduce the public debt;
- . privatised a number of these state owned enterprises and used the proceeds to reduce the public debt
- . reformed public sector administration and its financial accountability;
- . de-regulated the domestic markets for many goods and services;
- . liberalised foreign investment".

Extract from July 1992 Budget, House of Representatives, July 1992 (page 10).

Four elements are combined as part of the Government's strategy for economic growth:-

" . With its macroeconomic policies the Government aims to:

- sustain low inflation
- manage the risk associated with debt
- encourage investment through stable and predictable management of taxation and spending.

. The Government aims to help businesses build international linkages by:

- supporting greater international competitiveness
- enabling them to harness the benefits of international skills and capital
- promoting better international trade rules, assisting businesses to create networks of contracts overseas, and providing information and services to facilitate trade.

. With human resources the need is to achieve:-

- a productively skilled workforce
- lower unemployment

- investment in tomorrow's workforce

. A more competitive enterprise economy requires:

- a competitive cost structure

- better innovation

- better management and business performance".

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