Response to Business Set-up, Transfer and Closure Productivity Commission Draft Report, May 2015

by PPB Advisory

3 July 2015

Att: Dr Warren Mundy

Presiding Commissioner

Productivity Commission

GPO Box 1428

CANBERRA ACT 2601

Email: business.inquiry@pc.gov.au

1. Introduction

1.1. We greatly appreciate the opportunity to comment on the Productivity Commission's Business Set-up, Transfer and Closure draft report.

1.2. The primary authors of this submission are Stephen Parbery, Chairman and Founding Partner of PPB Advisory, former President of the Australian Restructuring Insolvency and Turnaround Association (ARITA), and former Director of INSOL International; and Mark Robinson, a Senior Partner of PPB Advisory, President of INSOL International and former President of ARITA. Our comments focus on the parts of the draft report that address business insolvency and restructuring and are borne out of our experience in significant insolvency and restructuring matters such as those involving Lehman Brothers, One.Tel, HIH Insurance, Ansett, ABC Childcare, Nine Entertainment, Gunns, Burrup Fertilisers, RM Williams Agricultural Holdings and BBY.

1.3. It is pleasing to note that the Productivity Commission's draft report supports a number of recommendations that have been on the reform agenda for considerable time. We also note that the report does not recommend wholesale change, but proposes targeted reform. We support this approach because we believe the key tenements of our Australia's restructuring and insolvency regime are fundamentally sound, though they could be improved in some key areas to foster a culture of business rehabilitation in Australia.

2. Executive summary

2.1. We advocate focusing on fostering a culture of business rehabilitation in Australia. Accordingly, subject to our commentary in the body of the submission below, we support the following recommendations in the draft report:

a) Australia does not adopt the US 'Chapter 11 bankruptcy' regime

b) suspension of ipso facto clauses during the Administration moratorium and 'safe harbour' periods

c) provision of a safe harbour for directors and their professional advisors from insolvent trading and other liabilities

d) pre-appointment sales of distressed businesses for proper purpose and reasonable value ('pre-packs')

e) unique director identification numbers.

2.2. For the reasons detailed in the body of our submission, we do not support the following recommendations:

a) administration only being available to 'potentially' rather than 'actually' insolvent companies

b) pre-appointment sales of distressed businesses (pre-packs) potentially being overturned in Administration

c) changing a Receiver's obligation from obtaining market value under Section 420A of the *Corporations Act,* to an obligation to not cause unnecessary harm to the interests of creditors as a whole.

2.3. We recommend the Commission considers the following initiatives, for the reasons outlined in our submission:

a) establishing an alternative dispute resolution (ADR) regime

b) establishing a panel of experts akin to the Takeovers Panel.

3. Support – Australia does not adopt the US 'Chapter 11 bankruptcy' regime

3.1. Chapter 11 bankruptcy is a fundamentally different regime because it is a 'debtor in possession' model, rather than an external administration model as in Australia. Given the long-standing convention in Australia of bestowing on creditors significant rights and interests in near-insolvent and insolvent companies, Australian business culture is unlikely to embrace such a debtor-friendly regime in the short term.

3.2. We agree that the Chapter 11 bankruptcy regime does not represent an improvement over the Australian regime in terms of speed and cost. However, further exploration of Chapter 11 in terms of maintaining higher business value for creditors and other stakeholders may be beneficial.

3.3. Many of the useful features of the Chapter 11 bankruptcy regime can be emulated through the clever application of the Australian Administration and Scheme regimes.

3.4. For these reasons, we support the recommendation that Australia does not adopt the US Chapter 11 bankruptcy regime.

4. Support – temporary suspension of ipso facto clauses

4.1. Increasingly in Australia, significant business value is generated by maintaining business contracts, as opposed to holding physical assets such as property, equipment and stock. Accordingly, temporary suspension of ipso facto clauses would greatly assist in protecting distressed companies as going concerns (and thereby maintaining value) while they are being restructured.

4.2. We are of the opinion that for the suspension of ipso facto clauses to be effective, it should not only apply during the Administration moratorium period, but also during the pre-Administration/pre-restructure 'safe harbour' period. Otherwise, suppliers and head contractors may deem a company entering into safe harbour as an ipso facto clause–triggering event.

5. Support – provision of a safe harbour for directors and their professional advisors

5.1. We support the recommendation to adopt a safe harbour from liability from insolvent trading, where a company's directors retain an appropriately skilled and experienced advisor for the purpose of considering the company's financial, trading and legal positions and, if appropriate, to attempt a restructure.

5.2. However, we believe there are gaps in the recommendation. Accordingly, we propose that safe harbour be extended as follows:

a) to also apply to appropriately qualified professional advisors to the company's directors. Otherwise, to mitigate their risk as 'deemed directors', the advisors may be unwilling to provide the necessary restructuring advice

b) to extend to a director's personal liability for the company's tax liabilities under the Australian Taxation Office's (ATO) Director Penalty Notice regime and under Section 588FGA of the *Corporations Act*. Otherwise, if the existing tax debt is significant and accruing, or if earlier payments of substantial company tax are at risk of being subsequently clawed back by a liquidator, a director will remain liable and reluctant to fully explore restructuring options for the company

c) in the case of listed companies, extending the safe harbour provisions to protect directors from their continuous disclosure obligations and liability. Otherwise, a director could be personally liable for an error or oversight innocently made while updating the market during the tense and complicated negotiation of an attempted turnaround or restructure.

5.3. We note that for large and sophisticated companies, which consequently have large and mature lenders and suppliers, adopting 'safe harbour' is unlikely to change existing practices. Generally, when in financial distress, a large company and its creditors will voluntarily enter into a negotiated 'standstill agreement' for an agreed 'standstill period' and abide by a number of principles – including refraining from the enforcement of claims, the provision of key company information including evolving restructuring proposals, cooperation between the company and its creditors (and between creditors), and the provision of funding – during the standstill period.

6. Support (but subject to significant amendment) – pre-appointment sales of distressed businesses, 'Pre-packs'

6.1. Given that a well-managed pre-pack sale of a distressed business most likely maximises the value for creditors, we support the proposal – but subject to our comments below.

6.2. For a pre-pack sale to be effective, the purchaser and the financier of the sale transaction, and the ongoing suppliers and customers of the business, require certainty that the sale agreement negotiated cannot be overturned and will be completed without delay. Otherwise, they will not consider supporting the distressed business or subsequently consummate a sale transaction because the risk of significant financial loss is too high.

6.3. Given our comments above, we do not support the proposal that where a pre-pack sale has been negotiated during the safe harbour period, the company must not complete the sale until it is placed into Administration and the newly appointed Administrator invests time and resources to investigate the sale, forms the opinion that the sale is for proper value, and only then consummates the sale.

6.4. We appreciate the concern that pre-pack sales must be undertaken for proper purpose and deliver reasonable value. Accordingly, we recommend that a panel of experts, akin to the Takeover Panel, be formed and that one of its roles be to provide an independent expert determination on whether a proposed pre-pack sale is for proper value and purpose. This is similar to the role of the 'Pre-Pack Pool' currently being considered in the UK following last year's Graham Review of the long-standing and regulator-sanctioned UK pre-pack regime.

6.5. We note that Arnold Bloch Leibler's preliminary submission to the Productivity Commission, dated February 2015, at paragraphs 3.31 to 3.36, details how such a panel of experts can be constituted and operate. We support this proposal.

7. Do not support – administration only available to ‘potentially’ rather than ‘actually’ insolvent companies

7.1. We do not support the recommendation that Administration be available to be initiated by ‘potentially’ insolvent companies but not those that are ‘actually’ insolvent.

7.2. The Administration process can preserve and enhance the value of insolvent companies. Examples include:

a) The underlying business of an insolvent company burdened with debt may be viable. Utilising the protection of the Administration moratorium period to sell the business undertaking and assets as a going concern can maximise value for creditors and preserve the employment of the company’s employees.

b) The ability through a deed of company arrangement to ‘cram down’ a compromise on dissenting creditors and/or inject fresh funds often returns an insolvent company to solvency.

7.3. Without the benefit of hindsight it is notoriously difficult to determine whether a company is insolvent or not. This is a widely acknowledged pre-appointment occurrence known as ‘the twilight zone’. Rather than placing a potential barrier in front of directors of distressed companies to seek professional help, we should ensure all restructuring options remain available to them.

8. Do not support – change a Receiver's obligation to not cause unnecessary harm to the interests of creditors as a whole

8.1. We do not support the recommendation to change the obligation of Receivers from achieving a market price under Section 420A of the *Corporations Act,* to an obligation not to cause unnecessary harm to the interests of creditors as a whole.

8.2. The recommendation is problematic on the following grounds:

a) Meetings of creditors and being responsible for the interests of unsecured creditors are not a feature of the receivership regime. There is cost and delay in the process recommended in the report, which would inevitably result in an increase in the cost of (and possibly limit the availability of) finance to business.

b) The protections afforded to unsecured creditors as a whole under Sections 420A and 433 of the *Corporations Act* already provide significant safeguards to those stakeholders from misuse of the Receivership process. Modifying this may in fact impair the protection and result in confusion.

c) If the intent of the recommendation is to streamline insolvency processes in favour of Administration, rather than the hybrid approach proposed in the report, we recommend instead exploring the Administration expansion path taken by the UK.

9. Recommend – establishing an alternative dispute resolution (ADR) regime

9.1. We recommend establishing an alternative dispute resolution (ADR) regime:

a) The insolvency industry plays an essential role in the orderly management of the affairs of insolvent businesses and individuals. Practitioners seek to maximise returns to creditors and preserve employment and social amenity, but also have a responsibility to act in the public interest. Practitioners are variously appointed by the courts, financiers and directors of distressed companies. However, most people exposed to insolvency have little or no prior experience of such an event and the role of the insolvency practitioner.

b) Creditors that have lost money are often angry, frustrated and disappointed. Their emotions may be directed at the practitioner and often exaggerated by the fact that the practitioner's remuneration is derived from the assets of the subject company, consequentially reducing the amount available for distribution to creditors. The fact that practitioners have priority over all other creditors is also a misunderstood cause of grievance.

c) The media has at times been highly critical of practitioners, particularly some notorious practitioners who have behaved egregiously (e.g. Stuart Ariff).

d) There is a perception that the existing complaints processes, including those of the regulator (ASIC), and the professional member associations, are too slow, ineffectual and lack independence. This is underscored by a lack of trust in the insolvency profession.

e) ARITA has advised that the majority of complaints are a "misunderstanding of the process being undertaken – often caused by a failure of effective communication" (submission to Senate Inquiry into the conduct of the insolvency profession).

f) Our firm's wide consultation shows there is a need for greater public education and improved communication and information about the insolvency process. There is also a need for a mechanism to deal effectively with stakeholders' enquiries and complaints, to protect the industry's, firms' and practitioners' reputations, improve standards and enhance trust.

g) Many complaints would be most effectively dealt with by an independent enquiries and complaints service, such as an ADR regime.

10. Recommend – establishing a panel of experts akin to the Takeovers Panel

10.1. We recommend establishing a panel of experts akin to the Takeovers Panel, as proposed in Arnold Bloch Leibler's preliminary submission to the Productivity Commission, dated February 2015, at paragraphs 3.31 to 3.36.

10.2. Establishing a panel of experts would provide:

a) a reduction in costs when compared to formal court processes

b) great assistance to stakeholders to reach commercially sound and pragmatic outcomes

c) independent expert determination on whether a proposed pre-pack sale is for proper value and purpose.

10.3. Members of the panel would be people with relevant experience, such as insolvency practitioners, bankers, corporate advisors and lawyers practising in the field of insolvency. Accordingly, the panel members would have the ability to understand and balance the interests of all stakeholders.

11. Conclusion

11.1. Thank you for the opportunity to comment on the Productivity Commission's Business Set-up, Transfer and Closure draft report. It is very pleasing to note that the Productivity Commission's draft report supports a number of recommendations that have been on the reform agenda for considerable time.

11.2. If you have any questions regarding the content of our submission or generally, please call either of the primary authors – Stephen Parbery or Mark Robinson