

Business Turnaround Association Inc

(Inc NSW 9879114 – ABN 80 974 508 210)

Level 7, 6 Underwood St

SYDNEY 2000

02 9247 7126

2/12/03

Mr John Kluver

Executive Director

CAMAC

By email john.kluver@camac.com.au

Dear Mr Kluver

Think you for the opportunity to make a submission to the Mac enquiry.

We attach for your information a copy of our submission to the Parliamentary Joint Statutory Committee on Corporations and Financial Services Inquiry into Australia's insolvency laws ("our submission"). You will see from our submission, the Business Turnaround Association is suggesting that the Australian economy would greatly benefit if there was a new pre insolvency system for companies that were in financial distress and that could benefit from rehabilitation.

The essence of our submission is the proposed formation of a Turnaround Panel to order oversee the rehabilitation or turnaround of companies that meets the Panel's criteria. We believe the Turnaround Panel could easily operate under the same or similar legislation to the Corporations and Securities Panel (which is usually referred to as the Takeover Panel).

The main function on the Turnaround Panel would be to receive submissions from companies in distress, evaluate submissions and if the Panel chose it could grant under certain conditions a moratorium from paying unsecured creditors for six months. Sections 3.1 and 3.2 of our submission give further details on how the panel could operate.

John I apologise for the lateness of the submission and that we have only been able to give comments on The Introduction and Section 1. The BTA is at the moment a voluntary organisation with no paid staff, if time permits and you would like us to comment on further Sections of your discussion paper please advise.

Yours Sincerely

Michael O'Neill

Committee Member

michael@pacificcapital.com.au

Comments on specific issues, which are raised in your discussion paper:

INTRODUCTION

- 0.1 This is the basis of the Business Turnaround Association (BTA) formation and it's submission to the Joint Parliamentary Committee.
- 0.2 We agree that companies that are insolvent or not economically viable should not go through a turnaround process, we address this by having an independent panel of professional and business people look at the companies.
- 0.6 The time frame in which it was planned that **VAs would have to be decided on, would not in our opinion be generally suitable for a business turnaround.** In particular the VA operating philosophy has developed generally that the best and quickest way to often deal with companies in VA is either to:
- sell quickly the business undertaking to the highest bidder and the creditors receive only a small proportion of the money they are owed or
 - put in a deed of arrangement where a payment scheme is made to a special fund that is distributed to creditors. Unfortunately a major creditor of such deeds, the Tax Office says there are few deeds that give creditors any reasonable returns.

The alternative is to Turn the company around and get it making profits and then if it cannot repay all creditors 100c in the \$ then look at a creditors compromise. We believe, it in the vast majority of cases where the business was saveable this would produce much higher returns for creditors.

Although the Harmer Report believed their process would be flexible, in the majority of cases this flexibility has not been used by the Administrators for the benefit of creditors and shareholders.

- .08 It is true some large companies have chosen to use the VA system rather than a scheme of arrangement. The point is however is that if there was a pre-insolvency system in place that could have operated before the companies became insolvent and it concentrated on operationally turning around the companies around, the losses to creditors would probably have been considerably less.
- .09 We are sure that the VA scheme has advantages particularly where there is no operating business and what is essentially required is a fast creditors compromise (or financial engineering). To judge the effectiveness of the VA system though we should look at what the opinion of creditors is i.e. how they have benefited from the deeds of arrangement of the VAs.

The Australian Taxation Office is one of the largest unsecured creditors of companies that go into a VA Deed of Company Arrangement. On page 7 of the Tax Depts submission to the Parliamentary Joint Committee looking into Australia's Insolvency Laws they said "It is the experience of the Tax Office that there are very few Deed of Company Arrangements that yield reasonable dividends to creditors"

This is a very strong statement and one that should be carefully considered in the discussion " is there is a better way to help companies in financial distress".

- .10 Regarding Chapter 11 – please see comments in our submission to the Parliamentary committee.
- .11 Security Holders. We agree that at this stage security holder's rights should be preserved. In our submission we structured our proposal to accommodate this. If it was shown that security holders were abusing their rights then the position could be re-looked at.
- .22 to .25 Defining large and complex enterprises. Our suggestion is that as a general principal the same definition be used, as that used by the ASIC in determining if a company has to lodge audited accounts. This would include public listed companies, and large private companies. For public unlisted companies, associations, and companies limited by guarantee we suggest that they be included if their structure and activities, would if they were private companies, mean that they would have to lodge accounts.

If the BTA's proposal for a Turnaround Panel was accepted we would suggest that the Panel have the general power to determine if a company should be eligible to be included.

- .27 The issues raised are worthy of consideration. In addition, the question of professionalism and conduct of VAs is something that should be discussed. In reality VAs are largely not responsible to any group or body that can monitor their actions. The majority of VAs are very professional but sometimes their actions are criticised and in practise creditors do not have a practical and economical way of having VAs actions reviewed by an authority.

SECTION 1

- 1.1 Agreed
- 1.3 Principal 1 – agreed

Prerequisites – we recommend that the directors should believe that the company may become insolvent within 12 months.

Who Controls - this is a difficult issue as currently it depends on the circumstances and the ability of the people involved. The BTA believes that the procedure that will give the best and most consistent results would be for a new body controlled by the ASIC called the Turnaround Panel to be vested with this control. See our submission for more details.

Personal liability – the BTA’s submission addresses this issue. We propose that while a company was undergoing a turnaround (approved by the Turnaround Panel) that for the purposes of calculating solvency, the unsecured creditors at the date of the approval be excluded. This may seem an unorthodox suggestion and some would say that it disadvantages unsecured creditors. The reality is however that the result of most Deeds of Arrangements is that unsecured creditors get a small portion of what they are owed. Refer to the Tax Offices comments in .09 above. If a turnaround is successful the group who would benefit the most are the unsecured creditors. A safeguard in our suggestion is that the Turnaround Panel would be monitoring the turnaround process and if it was not going correctly the Panel has the ability to end it. Directors would then probably appoint an insolvency professional.

- 1.4 We do not see this as a big problem because if the directors do not take meaningful action if the company is in distress then the probability is that it will fail and the loss of reputation will be much greater.
- 1.5 The issues raised are very valid. This is the reason why the BTA has recommended that there be a Turnaround Panel to oversee the turnaround process of companies. The Panel would make a judgement about the existing directors and senior managements ability and determination to carry out the turnaround. Experience has shown that in most instances of companies experiencing major distress, the CEO and Board have made a significant contribution to this.
- 1.6 Agree
- 1.7 We suggest that the basis for successful turnaround would require both a financial stress test and a purposive test.
- 1.8 If a company is not in financial stress or is unlikely to be in it in the next 12 months it should go through normal commercial channels to initiate an improvement in its operations. In practice directors generally do not put up their hands early and say they cannot themselves solve a company’s problems. We believe the Turnaround Panel could oversee such issues to stop abuse.
- 1.10 & 1.11 These functions would be overseen by a Turnaround Panel.

- 1.15 Agree
- 1.16 We believe the best controller would be a Turnaround Panel that has the necessary experience and authority to guide and control the turnaround process. The Turnaround Panel would agree the directors of the company who would be responsible for the implementing the agreed turnaround plan. The board would appoint an agreed CEO to undertake the actual managerial turnaround.
- 1.17 We believe that if some of or all the directors and senior management have made a material contribution to the company's financial problems, then they should probably be replaced.

We do not believe however that an external insolvency is generally the best or most experienced person to take over the company's affairs. Please see our submission.

- 1.18 We believe that although some external administrators have had good experience with companies undergoing insolvency, what is primarily needed is an experienced and successful CEO who has good experience with "turning around" companies.

Companies are managed and its staff carries out the operations of those companies. A successful turnaround normally occurs by using the majority of the staff already in the company with some key changes. The CEO needs to get his hands "dirty", be seen by everybody and not manage from "above". The CEO needs to be respected and put into place the strategy to re-motivate all the staff. The CEO's ability is not necessarily to get to know every detail of the business, but to make sure he/she can construct and lead the right management team.

- 1.19 We agree. An experienced CEO would obviously need to get to know the particular business, but with the help of good remaining staff and directors this is generally not a big problem. Remaining staff and directors are generally appreciative of a turnaround CEO being appointed as they have seen the company declining and are generally frustrated that nothing is being done about it.

The Board

- 1.20 The problem with Chapter 11 is that although some of the directors and management can be replaced, the initial group that make that decision is initially the old board. This old board may be honest and experienced people however they are still the group that has overseen the decline/demise of the company.
- 1.21 An experienced turnaround CEO can generally encourage the key executives in a company to stay.

1.22 We agree that if an external administrator is appointed it often encourages good executives to leave. We believe from experience that if a turnaround CEO is appointed it encourages good staff to stay especially if they believe that the company can be turned around and then will have a good future. Please see 1.18

1.23 We agree

1.24 We believe our proposed turnaround model caters for this situation.

Anyone Chosen by the board

1.25 We agree. The turnaround CEO however has to be in full control of the operations of the company.

Anyone chosen by creditors

1.26 This we believe could be dangerous unless it was supervised by an external party. There could be conflicts of interest and questions of experience and ability to debate.

Regulations of persons other than insolvency practitioners

1.27 There are 2 issues. The first is that although VAs are registered liquidators in practice there is little monitoring of their work by outside authorities.

The second issue is that our submission deals with this by having the Turnaround Panel monitor the turnaround process.

Role of the court

1.29 The US Chapter 11 Court procedure has advantages over the current system in Australia. We believe however that a turnaround procedure we described in our submission has the advantage of experienced business and professional people overseeing the turnaround process and our process would be more streamlined and quicker to deal with issues.

1.30 The costs of our turnaround panel process should be less than the US Chapter 11 system.

1.31 In Australia under the VA system, the courts do not have any significant role. If the VA system is being reviewed we believe that access to the courts to review the VA's decisions could give creditors a fairer outcome.

Creditors committees

- 1.32 We believe the most important thing to do initially in a turnaround is to stabilise the company and concentrate on operationally turning the company around. If this can be achieved and the company is able to pay all its creditors then all this time and cost in running creditors committees is not necessary.

In a situation where the company has undergone a turnaround but the company is still unable to repay all its creditors, then this is the time to start discussions on creditors priorities. At this time with the company restored to operational profitability creditors repayments should be greater than if they were agreed before the turnaround process was put in place.

- 1.33 & 1.34 From our experience, creditors committees have very little role and practical power under the VA system.

Personal Liability of directors for insolvent trading.

- 1.35 to 1.38 The question of trading while insolvent if a company is going through a turnaround or reconstruction is dealt with in our submission. The BTA model proposes that the turnaround board of directors has the ability to trade on with an amended definition of insolvency. This new definition excludes the unsecured creditors at the commencement date of the turnaround. See 1.3 for more details. Using our amended definition of solvency it also enables new continuing creditors to have normal commercial assurance that they will be paid.

Encouraging companies to negotiate with creditors

- 1.39 The important issue is that if the directors and management can put together a robust turnaround plan then this is the ideal time to approach creditors and seek their help in being part of the turnaround plan.
- 1.40 to 1.43 Generally agree. We do not believe that in Australia to date there has been widespread abuse by secured creditors of their position with companies going into VA

Reservation of title clauses

- 1.46 For large companies, it is often difficult to enforce this as the original product often changes nature i.e. it is processed and so the original products are often hard to identify

UK

- 1.47 to 1.51. In Australia in the early 1990s the banks did appoint a large number of receiverships, partly we believe because they did not see

any other practical way to deal with the defaulting company. Since the introduction of VAs in 1993, the economic climate has not created the problems that led to the conditions of the early 1990s and the VA system is now available to deal with companies in trouble. In some ways the UK process of making the “administrator” responsible to all creditors is good.

US

- 1.52 It has not been shown to our knowledge that in general abuse of the VA system has taken place by secured creditors.
- 1.54 The overriding “cramdown” rules available in the US would hopefully not be necessary in a turnaround model proposed by the BTA. We propose that if such powers were necessary the Turnaround Panel could apply to the courts for such an order.
- 1.55 The existence of the “pre-pack” negotiation system is an advantage over the court-supervised scheme. The issue often is however that before a reconstruction is attractive for new borrowings the company needs to demonstrate that it can turn itself around. This is often difficult under Chapter 11. Our BTA proposal allows the turnaround period to be investigated and hopefully partly or wholly implemented before extra funds are borrowed.

Loan Finance

- 1.56 to 1.61 (A) We believe it is important to be able to demonstrate clearly that the company is being able or is being turned around if extra funds would be available on any reasonable terms
- (B) We believe that our BTA turnaround model gives the company the ability to have extra working capital needed to generally continue in business. In achieving this it could be argued the existing unsecured creditors are put at further risk, but we believe that they would generally get a very little return from a normal VA (see Tax Office comments) and on a risk to return basis they are much better off.

Equity Finance

- 1.63 The reality we believe is that new equity will only come in if the new investors believe the company is, or has been operationally turned around.

Developing a plan.

- 1.65 The BTA proposal is that most companies do not in reality have say 6 months to develop a plan to themselves turnaround. Taking 6 months would often greatly adversely effect their customers and suppliers. We believe that the Turnaround Panel model should enable a relatively fast and good assessment of the company to be undertaken. If it was

believed by the Panel that a turnaround had a good chance of success and there was good management to lead this, the turnaround would commence as soon as possible. This would preserve as much as possible the relationship between all the trading partners and the company, thus increasing the probability of a successful turnaround.

Implementing the plan

- 1.69 The UK period that appears to be available for the company turnaround of 1 year is generally more reasonable and practical.

It must be remembered that the VA system in Australia does not appear to attempt to actually turnaround the company, but usually sell the company's business to an external or related party, without firstly trying to add value to the company's current position.

- 1.70 CAMAC we believe is correct in endeavouring to put a better system in place to streamline the rehabilitation of large companies

1.74 **Issues for Comment**

The above comments on specific issues will hopefully give further background on the reasons for the Business Turnarounds Association recommendation that a new pre-insolvency administration system is needed in Australia and we believe the structure we propose will go a long way to achieving this.

We would also recommend that the opinions of experienced turnaround professionals be considered in the discussion of the most appropriate way to turnaround companies that are in financial distress.