26th August 2014

Financial System Inquiry

GPO Box 89

SYDNEY NSW 2001

Financial System Inquiry

- **Funding External Administration**

We address your question:

> "Is there evidence that Australia's external administration regime causes otherwise viable businesses to fail and, if so, what could be done to address this?

Businesses Have Insufficient Options

The current Voluntary Administration outcomes discourage Viable Businesses in Financial Distress to consider entering the process. Directors correctly foresee considerable Value Destruction when faced with two largely unpalatable choices:

a. Voluntary Administration
b. An Urgent unwieldy Merger & Divestment Process

In both instances a "fire sale" outcome often occurs. The first instance is costly and has many other disadvantages. In the second instance Directors often take risks of Insolvent Trading and of being accused of a Phoenix Transaction.

We cannot provide evidence of Voluntary Administrations causing viable businesses to fail because our experience is that few viable businesses ever end up entering Voluntary Administration.

Voluntary Administration has become a cumbersome process with several possible outcomes. Whilst the objectives in Section 435A of The Corporations Act include to:

> "maximise the chances of the company, or as much as possible of its business continuing in existence",

a better solution is needed for <u>Viable</u> Businesses.

Therefore we outline in this submission a Solution to enable Viable Businesses to survive through a New Process.

Suggested Alternative to the Voluntary Administration Process

A New Procedure would be allowed in limited circumstances where (for example):

A Major Bad Debt has occurred threatening an otherwise Viable Business or a Sudden Change has occurred in the Competitive Dynamics of an Industry.

The Process will include:

1. An Independent Facilitator to approve and develop a Restructuring Plan before a formal announcement of the process
2. Throughout the Process the Facilitators' role is largely "Hands Off" thereby reducing the Costs of the Process
3. A strict short time frame would be set by legislation to reach an agreed outcome with creditors
4. Ipso Facto Clauses would be unable to be invoked
5. Usually Significant Changes to the Cost Base of the Business Must Occur resulting in a clear Cash Flow Surplus to enable Debts to be repaid within a reasonable time period.
6. The Outcome would be usually a Restructuring of the time period of repayment of existing Debt
7. As soon as creditors have agreed the Restructuring Plan a Quick Exit of the Company from the Process would occur. This would occur by placing Creditors in a separate "Creditors Trust" and the Trust would take security over the Company until the Debts have been repaid. Some of the Powers of the Trustee will be set by legislation.
8. No record of the Process would appear on the Directors Credit Record and the current Corporations Act "Two strikes and you are out" Director Disqualification would not apply.
9. Should the Business need to be sold, then the Company structure would be "Clean" and would encourage a purchaser to buy it intact with less costs and complications.
10. If cash flow projections are not met then the Trustee would take action under the Security.
11. Appropriate Strict Criteria would need to be developed. For example this process would not be appropriate for very small companies & in some industry sectors.

Concerns addressed

The above Process addresses need and/or responds to changes occurring in the marketplace:

a. It provides a Structure to help Viable Businesses survive with less cost and disruption. Therefore Directors will be encouraged to act much earlier.
b. Management are "freed up" to run the business whilst an Administrator deals with only the Insolvency Issues.
c. The Facilitator is also "freed up" from non-value added tasks such as numerous regulatory & compliance tasks, running the business, detailed investigations, etc.
d. Banks are often appointing Receivers & Managers to deal with Commercial Issues whilst they also insist that the Directors appoint a Voluntary Administrator to the same company. The Administrator then deals with Compliance and what the Banks see as necessary but non-value adding tasks etc. The Banks are responding to clear and similar needs that the suggested new Process addresses in a different way. Furthermore if a Bank has confidence in the Facilitator, they may allow the suggested new Process to occur instead of a Receivership – at much cheaper cost to all parties.
e. Major Creditors would particularly become engaged again and this may encourage flexible solutions. For example smaller creditors may be repaid in full in priority to larger creditors.
f. New Financiers would be more confident to refinance existing debts.
g. Recent changes to Tax Laws for Directors Personal liability may man that in the future Viable Businesses will not usually have large Tax Debts. Therefore the typical Stakeholders will be different.
h. The current "stigma" of a Voluntary Administration would not occur.
i. The Costs would be considerably less.

Similar Processes

In the United Kingdom, "Company Voluntary Arrangements" have a similar Process.

The New Process would be significantly different to the former "Official Management" procedure which largely was not utilised in Australia.

Bruce Mulvaney

I personally have worked in Company Insolvency & Restructuring since 1977. I have a keen appreciation of the issues facing distressed businesses and the changing competitive landscapes in which they operate.

Conclusion

Distressed Viable Businesses currently do not have a simple Process to help them. This Process will provide a solution.

We will be pleased to discuss this letter with you.

Yours faithfully

Bruce Mulvaney

Principal