KordaMentha

2 March 2010

The Manager
Governance and Insolvency Unit
Corporations and Financial Services Division
The Treasury, Langton Crescent
PARKES ACT 2600

Email: insolventtrading@treasury.gov.au

Dear Sir/Madam

This submission is made in reply to Treasury's recent paper entitled 'Insolvent Trading: A Safe Harbour for Reorganisation Attempts Outside of External Administration'.

Introduction

In recent months there has been debate concerning the operation of Australia's laws prohibiting a company from trading whilst insolvent. Part of the debate has been whether these laws result in companies entering into administration prematurely or inhibit companies restructuring outside of external administration. A second part of the debate is what can be done to improve the law to promote rehabilitation of companies outside of external administration.

In preparing this submission we draw upon our own experiences and have interviewed a large number of insolvency practitioners, lawyers, directors and bankers and reviewed 20 large administrations / liquidations:

- Ansett
- HIH
- Pasminco
- Sons of Gwalia
- Yandal Group
- Allco
- Babcock & Brown Limited
- Lane Cove Tunnel
- Cross City Tunnel
- FreightLink
- Henry Walker Eltin
- Griffin Coal

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- Stockford
- Timbercorp
- Great Southern
- ION
- ABC Learning
- MFS
- Opes Prime
- Fincorp

We also reviewed 10 large workouts. The individual companies cannot be identified:

- Company Group 1 (large multi-national corporate)
- Company Group 2 (financial services)
- Company Group 3 (real estate)
- Company Group 4 (infrastructure)
- Company Group 5 (travel)
- Company Group 6 (property)
- Company Group 7 (entertainment)
- Company Group 8 (financial services)
- Company Group 9 (tourism)
- Company Group 10 (health care)

Our paper only deals with large companies, not the SME market.

The purpose of this submission is to provide a series of observations to promote informed discussion. Accordingly, our observations within this paper are not intended to contradict in any way the submission of the Insolvency Practitioners Association (IPA) on this issue, the basic principles of which we have considered and support. Our observations are as follows:

1. Evidence does not indicate that external administrations are occurring prematurely

From the numerous discussions and interviews we conducted, and our review of 20 large administrations/liquidations, we found that in all but a few cases those involved did not believe that the external administration had occurred predominantly because of the trading whilst insolvent laws (and in those cases the views were not unanimous). We found that the decision to appoint external administrators occurred mainly because the company had run out of options. The fundamental problem was the loss of key stakeholder support, without which any form of restructuring could not have occurred.

However, our review of large workouts provided more insight into whether the trading whilst insolvent laws prevented a better outcome.

2. Current trading whilst insolvent laws could be changed to assist workouts

Our research shows that there is no doubt the trading whilst insolvent laws result in the directors being very focused and concerned. This is appropriate and seen as a real benefit.

However, a number of people we interviewed indicated that during what is colloquially referred to as "the twilight zone" (the period leading up to insolvency) the fate of the company **"could have gone either way"**. That is, the directors were sufficiently concerned about the consequences of trading whilst insolvent laws to seriously consider formal administration rather than a workout even where there was no doubt a workout was the preferred course of action.

Therefore to reduce the risk of it **"could have gone either way"**, well drafted safe harbour provisions could assist. The challenge will be to get the balance right and not provide directors with an excuse to go too far.

3. The question of corporate solvency is open to interpretation

Many of the people interviewed agreed that the identification of insolvency is an art, not a science, and open to interpretation and debate. It was generally agreed that the views and opinion of advisors in relation to the solvency of a company can differ substantially depending on whether they adopt a "liberal" or a "conservative" view on the law. The decision to pursue a workout should not be so influenced by interpretations of the law. Well drafted safe harbour provisions could help manage this issue.

4. Some companies are less suited to external administration than others

A common theme arising from our research is that companies whose enterprise value is somewhat or wholly dependent on goodwill or public sentiment, are those for which the external administration process is most perilous (e.g. travel business dealing with the public with advance payment for services). For some companies, the appointment of an external administrator would result in a total and irreversible loss of public confidence which itself presents an insurmountable obstacle to the restructuring of the business.

Accordingly, changes to the law that will help a workout of these companies, and reduce the fall in enterprise value that would occur through a formal insolvency process is encouraged.

Compounding this issue is the operation of ipso facto clauses which often result in the termination of critical contracts, licenses or agreements and crystallisation of liabilities. Law reform in this area is needed, but it is complex e.g. lenders usually do not want to continue taking market risk for derivatives.

We note that option three of the government's discussion paper proposes a moratorium under which the corporation's difficulties would be publicised to its creditors is problematic for the reasons stated above. We believe this option is not viable.

5. Current laws make it difficult to attract new capable management and directors

It is often the case that existing management and directors lack the necessary expertise to manage a company through a workout process. A common theme in our discussions is that a competent director or senior manager would not knowingly subject themselves or their personal assets to the risks associated with taking a new appointment with a company in the "twilight zone". Safe harbour provisions could encourage new capable management, directors and competent professionals to participate in workouts.

6. Well drafted safe harbour provisions

The current trading whilst insolvent laws ensure directors are very focused. We strongly caution that any changes to the law need to ensure that the laws do not dilute this focus, but ensure, when appropriate a workout can be pursued.

Yours sincerely

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