Australian Shareholders' Association Ltd
ABN 40 000 625 669

26 November 2003

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001

Dear Mr Kluver

ASA Submission on Corporate Recovery Discussion Paper

We understand that you are seeking submissions from interested parties on the Discussion Paper on rehabilitating large and complex enterprises in financial difficulties by Friday 28 November. We attach our contribution.

Yours sincerely

Stuart Wilson
Executive Officer

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ASA Submission on Corporate Recovery Discussion Paper

Introduction

The Australian Shareholders' Association welcomes the opportunity to emphasise the interests and rights of shareholders in the discussion of corporate recovery. The current administrative and liquidation practice ignores shareholders' interest in the progress of the procedure and trivialises entitlement to any residual on wind up by the assumption there will be none. We trust that the ASA's input is constructive and useful.

Australian Shareholders' Association Position

- Continue market announcements, including releasing s439A statement and progress of agreement with creditors, in order to maintain disclosure to shareholders and others, via ASX. (Currently tracked through www.delisted.com.au)
- Prevent administrators from guaranteeing immunity from recovery action to management or directors
- Institute independent approval process where assets are sold to administrators, major shareholders or directors of the company
- Place a time limit on production of liquidator's certificate or grant shareholders an entitlement to a capital gains tax deduction immediately recovery action is instigated (with any subsequent return being fully taxable in the year of receipt)
- Solvent companies should not be allowed to enter voluntary administration. Management and directors are charged with managing creditors and cashflow
- Concerns regarding Chapter 11 and moral hazard - the desire to preserve the interests of creditors, employees and company, while admirable, may allow ongoing poor management and financial decision making, increasing the losses flowing to the shareholders of the company and placing competitor companies at risk.

Chapter 1 Principles for effective corporate rehabilitation

Timely remedial action needs to be encouraged so that there is a surplus for shareholders.

Debate over loss of expertise of directors and other management if external administrator appointed:
Companies generally face insolvency when they have made imprudent investment decisions or misjudged risks. If the existing board and management have taken early action to avoid insolvency then they should continue in the role. However in many cases fraud, dishonesty, incompetence or gross mismanagement has led to insolvency, and as in the Ch 11 regime, close external supervision of the board is required.

1.34 The employment of professional advisers may well drive up fees beyond the external administrator role, though the introduction of a panel similar to the takeover panel has merit for both introducing expertise and controlling costs. On the subject of fees, the lack of transparency to the fee setting mechanism for administrators leaves shareholders believing the administrator has walked away with what was formerly the shareholders' residual.

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1.62 Equity Finance - there is little incentive for small shareholders to provide new equity to ventures that are already in difficulty. The interests and rights of existing shareholders have been limited in Chapter 1 of this discussion paper to the provision of further capital. Encouragement of new equity is difficult as it creates two different classes of shareholder - the rights of each class of shareholder are not easily balanced and rationalised. Often original shareholders would like to consider providing additional equity at discounted prices.

The US Ch11 regime allows six months for the production of a rehabilitation plan while VA allows one month. A company is required to be heading for insolvency to initiate voluntary administration, therefore the imperative for creditors to agree a course of action is greater and a shorter timetable is appropriate. A listed entity is professionally managed and has the resources to negotiate with its creditors while a going concern. Any lengthening of the time periods allowed appears to reduce the responsibility of the management and board to be on top of its business situation. The opportunity of an application to the court for an extension to standard timing gives appropriate flexibility for recovery of large and complex entities.

Other considerations: For sustainable companies, directors and management are required to adopt prudent employee, investment and financial practices throughout the business cycle. Given the action of a participant in one market will spill over to others within that market it is critical that any special treatment does not jeopardise well run entities.

Pursuing the suggestion of better returns for creditors and shareholders: the current situation and suggested amendments seem to ensure that creditors and administrators are more likely to receive recompense than shareholders. Adding to the sense of shareholders' injury, the sometimes-lengthy delay in receiving the Liquidator's Declaration is at odds with the presumption of nil return to shareholders.

Chapter 2 Voluntary Administration

A company entering Voluntary Administration often surprises shareholders, who have the most recent annual report showing it as a going concern. Given the difficulty of assessing the likelihood of insolvency at some future time without internal documentation, it is little wonder shareholders are concerned their financial rights are being exploited.

2.25 If already insolvent, a company should liquidate due to lack of chance for recovery and the risk of consuming more assets in a failed attempt.

2.26 The premise that liquidation is slower than VA to initiate, provides a reason for allowing insolvent companies to use VA ie protects directors from liability from insolvent trading: While establishing insolvency is tricky, expanding the use of VA may encourage risky behaviour. Shareholders more likely to get a return if there is a greater financial buffer at time of attempting resuscitation. Also creditors are not interested in residual for shareholders therefore putting more power in creditors' hands by allowing solvent companies to enter VA is distasteful.

Better returns for shareholders - deed of company arrangement. Often shareholders feel as if they have little say in the situation, even where they are able to vote on the deed. The binding of the officers and shareholders - while shareholders are given an opportunity to vote - it often seems there is an inequality of information with large shareholders having a greater say in the outcome.

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2.34 The entitlement that individual creditors may retain the right to apply to the court to appoint an administrator - the court prevents frivolous use of this power and shareholders may perhaps receive earlier warning of solvency troubles than otherwise.

Eligibility of a liquidator to be an administrator:

Large and complex enterprises require experience of running such organisations. There should be a special class of administrator, who should have access to executive expertise or the suggested turnaround panel.

Concerns regarding US style Chapter 11 proceedings:

Chapter 11 time-line seems too long especially if recovery is not assured.

The American airline companies have been in and out of Chapter 11 bankruptcy over the past two decades. The companies are highly operationally and financially leveraged with high capital intensity and large workforces. The existence of Chapter 11 has led to persistent imprudent employee agreements, over-investment in aircraft fleet and inadequate capital structure. Chapter 11 has become a competitive tool in this industry, making it more difficult for competing companies to operate prudently throughout the economic cycle. In the good times wages, debt and capacity, in the form of additional planes, ratchet up and prudent companies are forced to match imprudent practice to maintain market share. Inevitably the economic cycle turns down and the companies use Chapter 11 to restructure.

More generally, as a method of creating sustainable companies, Chapter 11 has mixed success. Lynn LoPucki, Professor at the law school of University of California, Los Angeles has built a database of all public companies with assets over $100m that have filed for Ch 11 Bankruptcy since 1980. Only 83 out of 569 times did a restructured company fail to emerge from bankruptcy. However many of the companies return to Chapter 11. Of the companies emerging from bankruptcy during 1991-1996, within 5 years 29% had gone out of business. Edith Hotchkiss of Boston College found that more than half Ch 11 restructurings fail.

Australian time-line:

Sufficient flexibility is allowed with the ability to extend Australian deadlines by application to the court or agreement of the creditors. The ASA would support the granting of express power to the court to extend any of the time periods for a proper purpose. Administration is costly and the longer it drags on the less surplus available to shareholders and employee entitlements, and the more competitors' and suppliers' finances are impacted.

The first meeting time should be no longer than 10 working days after appointment.

Information: notification letter via fax appears reasonable to the ASA as the billing department would have contact details for all creditors **plus release to ASX**. Provision of documents via the company's web site and comprehensive advertisements directing interested parties to website would be cheaper than current requirements and allow shareholders to keep in touch with the progress.

Administrators remuneration is quite steep - it is difficult to set fees purely as a proportion of assets given that airlines have high level of assets but in Ansett's case no surplus. Complexity should also be factored into the equation, and time spent - hence the desire for a speedy procedure.

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Equity for Debt swaps - the current law is adequate. It grants flexibility in relief from takeover provisions for Voluntary Administration. No takeover required if approved by shareholders or if no original equity persists. Prospectus should be required if additional cash required from creditors, unless they are professional investors.

2.149 where shares in the company have no value, the interests of these shareholders do not require protection (evidence required should be Liquidator's declaration).

2.1525 retain current law. Shareholders' approval is often grudgingly granted though they feel their rights are being overlooked - as stated on p 46 there may be an excess of assets over liabilities despite an inadequate cashflow for solvency. Shareholders often feel exploited by schemes of arrangement.

2.157 If takeover exemption were extended to Voluntary Administration: shareholders that believed their interests would be adversely affected under the deed of company arrangement could apply to the court to have the deed terminated. This is impractical on an individual retail shareholder basis. Typically the cost of mounting an action and the risk of eroding any residual value would outweigh the desire to terminate the deed.

2.222 A Company should be solvent at the time of the commencement of the deed of arrangement in order to maximise chances for success.

Financial reporting requirements - shareholders feel their interests are automatically assumed to extinguish with any recovery action. While it is agreed that standard going concern reporting is no longer appropriate, at the very least they have an interest in the timing of the liquidators declaration which may represent the only value left to them (CGT tax loss). Further, the ability to judge whether the residual has been maximised (though at no point in this discussion paper is any one charged with optimising the outcome) would be assisted by ongoing reporting of eg s439A report, creditors proposals etc.

2.234 Changing company name without shareholder approval would only seem to facilitate Phoenix organisations. Despite fondness for the names of some companies that are going concerns, shareholders approve name changes regularly.

Chapter 3 Creditors' Scheme of Arrangement

Scheme of arrangement - doesn’t require insolvency, and therefore may threaten shareholders residual interest in the shares unnecessarily.

3.4 Where a scheme involves transferring the whole or part of the undertaking, the property or the shares of one company to another company, the court may make various facilitative orders to achieve this end. Approval should be required via an independent approval process where assets are sold to administrators, major shareholders or directors of the company

Creditors scheme of arrangement may restructure equity base. Small shareholders often feel exploited by more powerful bargainers.

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