

Business Turnaround Association Inc

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The Secretary
Parliamentary Joint Committee
on Corporations and Financial Services
Room SG.64
Parliament House
CANBERRA ACT 2600
16 June 2003

Dear Sir/Madam

We attach the submission of the Business Turnaround Association and thank you for your indulgence in extending the date for receipt of this submission.

Having read the Committee's "Issues Paper" and some of the submissions we agree that many of the points raised by submissions on the current Insolvency Laws are valid and should be addressed by the Committee.

With your indulgence we would like to present a wider view of major issues that are involved in Australian companies failing and becoming insolvent. We believe the Australian community would substantially benefit if the Commonwealth Government and the Corporate regulations were able to encourage the development of a business turnaround culture for businesses in financial difficulties.

Last year a group of interested industry professionals decided to form the Business Turnaround Association Inc to be a forum for an Australian turnaround focus, it was coincidental but opportune that the Joint Parliamentary Committee called for submissions on Australian Insolvency Laws in December 2002.

We attach a submission which centres on a system to assist companies undertake a "turnaround" of their operations so they are able to be restored to profitability and repay their creditors 100 cents in the \$. Shareholders would of course also be significant beneficiaries of such turnarounds.

An integral part of the proposed system is the formation of a Business Turnaround Panel, which would operate under the guidance of the ASIC. The Turnaround Panel would operate under similar rules to the current Takeovers Panel.

The attached submission also recommends:

- the Business Turnaround Panel would be constituted by people with extensive business and corporate experience
- the Business Turnaround Panel would oversee the business turnaround
- there would not normally be any court involvement with the process
- the powers of the Business Turnaround Panel must be flexible to enable a turnaround protection/moratorium period of six months to achieve the turnaround
- legal protection must be provided for all persons involved in the turnaround process during the turnaround/moratorium period
- during the moratorium period existing unsecured creditors would be excluded for purposes of insolvency regulations
- the position of secured creditors must be acknowledged

The existing system of Voluntary Administration would be retained as that system would continue to be utilised in appropriate circumstances.

The Submission has been prepared by a Working Party of the Association including the following:

Richard Fisher (Chairman - Blake Dawson Waldron)
Peter Hedge (Partner – PricewaterhouseCoopers)
Brian Mahoney (Director – Financial and Corporate Relations)
Michael O'Neill (Managing Director – Pacific Capital Corporation Ltd)
Robert Sauer (Chairman – Dibbs Barker Gosling)
Peter Thomson (Executive Director – Pacific Capital Corporation Ltd)

The Business Turnaround Association would be pleased to assist the Committee in development of a more effective system of enabling companies to be returned to profitability and save the substantial huge community costs of business failure.

Yours Faithfully

M P O'Neill
BTA Committee Member
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Australia's Insolvency Laws

Submission by Business Turnaround Association Inc for a new legislative model for business turnarounds and the establishment of a Turnaround Panel

General background information.

The Business Turnaround Association was incorporated in January 2003 and its strategic objective is to advance Australia's capacity for business turnarounds and reconstructions. This would save the country the cost of many business failures and increase Australia's economic activity and productivity. To achieve this goal, the Business Turnaround Association will:

- assist in the creation of a certain and consistent environment that is favourable to the development of business turnarounds and reconstructions;
- create a group or groups of members who will assist businesses to understand the issues involved in business turnarounds;
- promote a bi-partisan agenda in which Association members may participate to develop long-term and consistent public policy for business turnarounds and reconstructions;
- promote greater public awareness of the benefits associated with business turnarounds and reconstructions;

Australia as a country is losing hundreds of millions of dollars each year due to companies getting into financial difficulties and then becoming insolvent. Once in this position they are unlikely to pay creditors, employees and governments all the money that is owed. As well as the high profile collapses (HIH, FAI, Ansett, Harris Scarfe UMP and OneTel) there are hundreds of other medium and smaller companies that cause substantial damage to the economy and personal lives.

A Fundamental concern for the Business Turnaround Association is the present legislative system which encourages a financial restructure of the affairs of companies in financial difficulties (i.e. a compromise or arrangement with creditors) and does not encourage operational issues which adversely effect a company's performance to be identified addressed and corrected as a matter of priority.

This submission concentrates on the following areas

1. Comments on existing Insolvency laws
2. Background to new model of dealing with companies with financial and management problems.
3. Major features of our proposed "turnaround" model and an example of how our proposed Turnaround Panel could work
4. Establishing a turnaround business culture in Australia.
5. The Business Turnaround Association

1. Comments on existing Insolvency Laws

If companies go into a formal insolvency scheme such as provisional liquidation, liquidation, receivership or even voluntary administration it is generally accepted amongst the insolvency profession that these legislative insolvency schemes themselves destroy value in the companies. This is not through any fault of the Insolvency Practitioner. One of the major problems causing the destruction of value is that existing contracts, which benefit the company, can generally be terminated and many extra liabilities become due when the company commits an event of default. This is typically defined to include the appointment of an Insolvency Practitioner or Voluntary Administrator.

The Voluntary Administration (VA) scheme which was introduced in the early 1990s was certainly an improvement on the more restrictive options of provisional liquidation or liquidation for most insolvent companies. A major shortcoming of the Voluntary Administration scheme is that it is normally impossible to predict the outcome of any scheme within the one-month time limit in which the voluntary administrator has to put the formal scheme to the company's creditors. In addition voluntary administrators who are accountants by profession often do not have experience in business turnarounds.

The VA scheme generally relies on performing some "financial engineering" or selling off the company's assets very cheaply as it is generally impossible to "turn" a company around and/or promote its sale or recapitalisation at a price that gives all creditors 100 cents in the dollar in the allowed time. We believe that the vast majority of VAs, which are considered successful, involve creditors (usually unsecured creditors) losing a majority or substantial amount of the money they are owed.

It is appreciated that not all companies which go in to insolvency administration would be capable of being "turned around", this is particularly the case when fraud has been involved or when the Board of Directors has been consistently misled or the process is being used as a de-facto winding up.

2. Background to new BTA Model of dealing with companies with financial and management problems

In our opinion Australia's Insolvency Laws/systems could be changed to successfully assist many more companies that get into very difficult financial positions. This system would be structured to achieve an operational "turn-around" with no or minimum financial loss to creditors (especially unsecured creditors).

A major issue where a company is unable to pay all its creditors is that the process of dividing up the available money often results in costly legal issues concerning the admissibility of creditors and their priority. This delays the time before anyone is paid. If a company can be turned around and repay all its creditors then this costly and time consuming process is avoided.

This "turn-around" philosophy is occurring in an informal way now, especially amongst the major banks where the bank encourages a "turnaround" of a customer company. These turnarounds are often driven by bank staff and outside consultants. Unfortunately there are no reliable statistics available to us on such projects.

We see two key elements of advantage to these business turnarounds: firstly, default provisions in contracts are not automatically triggered, and secondly, the focus is on operational and management changes needed to return the business to profitability.

The cause of the vast majority of business failures is **bad management**. Occasionally a major adverse event can occur that good management would not normally plan for, however the vast majority of business failures are due to bad operational management and planning.

If bad management is recognised early enough and corrective action taken, businesses can

often be saved and made to prosper. In most cases of a business failure, the Chief Executive Officer (CEO) generally has made a major contribution to the problems. In addition the existing directors have typically failed to adequately monitor the company's operating and financial position.

In the USA a system referred to as Chapter 11 operates where companies, which have financial problems can seek the protection of the court to gain a period of protection from current creditors while the company undergoes a reconstruction or "turn-around". A common period of protection is one year.

Although many companies come through the Chapter 11 system successfully we understand the system could be improved and that it is sometimes exploited by directors and management of companies seeking protection. We understand that the Chapter 11 scheme is flawed because:

Firstly, the control of companies entering Chapter 11 remains vested in the existing directors and management, who were in office when the company developed its financial problems
Secondly, the scheme is a court supervised one making it inflexible and expensive and sometimes cumbersome when dealing with commercial issues that have to be settled quickly and

Thirdly, it sometimes undermines the position of secured creditors.

We do not believe that Chapter 11 as it presently exists would be appropriate for Australia and think that there would be a better model on which we could base a "turnaround" culture amongst the business community.

We believe that serious consideration should be given to creating a formal company "turnaround" process. The Business Turnaround Association would be pleased to participate in the necessary debate by all the proper stakeholders (including parliament, financial institutions, commercial organisations and other industry professionals).

The creation of a formal "turnaround" process should greatly increase the effectiveness of saving companies and enabling them to continue in business. The saving to the Australian economy, including Governments, employees and creditors would be substantial.

3. Major features of the BTA proposed "turnaround" model and an example of how our proposed Turnaround Panel could work are as follows:

3.1 Turnaround Panel

- It is proposed that the Federal Government supports the establishment of a Turnaround Panel, which would operate under the umbrella of the ASIC.
- Such a Turnaround Panel might be achieved either through a mirror image of the statutory and regulatory framework which constitutes the Corporations and Securities Panel (which is usually referred to as "the Takeovers Panel"), or by vesting the relevant extended functions in the existing panel.
- The Turnaround Panel would comprise experienced and respected CEOs and appropriate professionals and in general would be charged with responsibility for overseeing the implementation of plans to effect the turnaround of companies. It is an important element of our proposal that a business experience and commercial focus be brought to the task in a similar fashion to the concept behind the Takeovers Panel and the aim would be to have Members in each capital city.
- The powers of the Panel would be wide and they would be able hear submissions from companies seeking to undergo a reconstruction or turnaround. A core of available Panel members would be formed to adjudicate and administer the process for each submission.
- The main function of the Panel would be to decide if there was a sufficient commercial case to grant a moratorium from unsecured creditors for 6 months to enable a company to undergo a business turnaround.
- The Panel would agree on processes to be undertaken by the Panel before deciding on particular proposals

- In order to avoid dealing with large numbers of small enterprises, access to this process would be limited to companies meeting certain “significance” criteria, e.g. employing more than say 50 employees, and/or total creditors/debt of more than \$5 million.
- The Panel would decide appropriate terms and conditions for any moratorium, including the appointment of new approved directors and a CEO. The Panel could also specify the reporting system it required and if it wanted certain goals to be achieved at set times.

3.2 Example of a Turnaround Panel procedure

- The directors of a company are concerned that the company may be in or is getting into severe financial difficulties. They believe however that if the company could be turned around it may have a good future. The directors may or may not have a plan to do this and they may or may not believe that the existing management is capable of successfully implementing the turnaround. If the directors believe that the company may become insolvent within 12 months they can approach the Turnaround Panel.
- The Panel would decide how they were going to assess the company, this may include taking advice from outside consultants.
- The Panel would decide appropriate terms and conditions for any moratorium. In many companies, which are in need of a “turnaround”, this can best be achieved by an injection of new blood at a director and CEO level. Accordingly one of the conditions which the Panel might impose could require the appointment of suitably qualified and experienced directors and management.
- The Panel could also specify the reporting system it requires and if it wants certain goals to be achieved at set times.
- The moratorium would apply to unsecured creditors and the aim is that if successful, the unsecured creditors would receive 100 cents in the dollar, whereas if the company entered into a traditional insolvency scheme unsecured creditors would probably receive far less than this.
- A Turnaround Panel moratorium would not affect the position of secured creditors and they could take any action empowered to them under their security documents. To enable the Turnaround Panel to be effective new legislation would have to stipulate that the approach to the Panel or orders by the Panel would not in itself be an event of default under any security or other contractual documentation.
- In determining whether the company is solvent for the purposes of the directors’ obligations, moratorium creditors would be excluded for the period of the moratorium.
- The company would be subject to market forces for its trading during the moratorium period
- At the end of the moratorium period, hopefully the company has been able to achieve the operational turnaround and be able to pay all creditors as they become due. If this is not fully achieved the directors may endeavor to negotiate a repayment scheme with creditors based on the improved operating performance of the company. If the company has not re-established its commercial and financial viability then it would be dealt with under normal insolvency legislation with all creditors (pre-moratorium and moratorium) ranking equally.

We believe such a model for dealing with companies in financial difficulties should save many more companies and their creditors, employees and shareholders from losing hundreds of millions of dollars.

There would be other issues needing to be addressed. These are likely to include; the liaison between shareholders and in particular institutional shareholders being deemed to be acting in concert if they co-operated to bring about a needed turn-around (including the appointment of the necessary directors to achieve this).

4. Establishing a Business Turnaround Culture in Australia.

The benefits of a successful Turnaround industry in Australia would be substantial. Business failures cause Australia enormous cost, both economic and personal.

The group that has the immediate responsibility to monitor the performance of companies and CEOs are the directors. History has shown though that directors are often not effective in monitoring the CEO and corporate governance in a company particularly where the CEO has a strong personality.

Being realistic we will always have failures, as our society is based on encouraging free enterprise and innovation and not all business ventures will be successful. What would be helpful would be to have a commercial system that identifies these failing businesses before they lose too much money and cause large losses to creditors, employees and governments.

Until now there has not been a widely recognised "Business Turnaround" culture in Australia where there is a group of professional and experienced executives who are available and capable of being commissioned to take charge of a failing company and "turning it around" to profitability.

5. The Business Turnaround Association

The lack of a recognised and effective business turnaround culture is unfortunate as an effective industry would help prevent the enormous waste that occurs when business enterprises collapse. To rectify this in January 2003 a group of interested Industry executives formed the Business Turnaround Association (registration number INC 9879114)

The overall objectives of the Business Turnaround Association (BTA) are set out on page 1. Additional initial objectives of the BTA are:

- Coordinate support groups/organisations that are able to make a positive contribution to companies requiring business turnaround skills.
- Put in place systems that can be used by shareholders/directors as sources of information and discussion points regarding companies that need some form of reconstruction
- Make the availability of these member services known to shareholder groups and directors of companies
- Allow shareholders and/or directors access to member groups of the association and for them to conduct their own evaluation of the appropriateness of the association's members.

Turning businesses around is a specialist role and often senior executives who have been successful in general management fail when they attempt a turnaround. The reason we believe is that they do not have the experience necessary to address the additional issues that are involved in a turnaround. Despite this there are individuals who have had experience of turning a number of businesses around and experienced non-executive directors who have been on the boards of companies that have undergone successful turnarounds. There are also other groups of professional service providers who have hands on experience in turnaround situations, particularly amongst the accounting and legal professions

It is proposed the Association would build up over time the following member groups:

- Chief executive officers
- Non executive directors and chairpersons
- Accountants
- Lawyers
- Communication and public relations firms
- Financiers/investors

- Shareholder groups
- Consultative reference groups

At this stage it is believed that within the Association there should not be any "insolvency" group, as the prime aim of the Association is the turning around of companies before they require the services of insolvency practitioners to deal with the company under corporate insolvency legislation. If a company is being dealt with by an Association member and needs to be dealt with under a formal insolvency arrangement then these companies should be referred to a member of the Insolvency Practitioners Association. The BTA will have as members accountants who have had insolvency experience, but intend to use their skills as investigating accountants and consultants rather than as "corporate undertakers".

Directors of course control the day-to-day activities of the company and it is their decisions on policy and management which determine success or otherwise of the company. This being the case it is sometimes difficult for directors to acknowledge that they are not able to solve issues that may cause the failure of the company. Hence it is recognised that sometimes directors would not be the group to come forward to an association such as ours and admit they are not able to solve major issues. The Association therefore has to make its presence known to shareholder groups and significant individual shareholders.

On the other hand, directors of failed companies are sometimes heard to claim that they did not know whom they could turn to in order to seek assistance of this kind without automatically triggering events, which would lead down a pathway to the formal insolvency regime. We would hope that the formation of the Association, and the establishment of the Turnaround Panel and related legislation, would give the directors another practical avenue to pursue.