Ansett

Part 5.3A and Chapter 11

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The KordaMentha Research Unit
Paper 301

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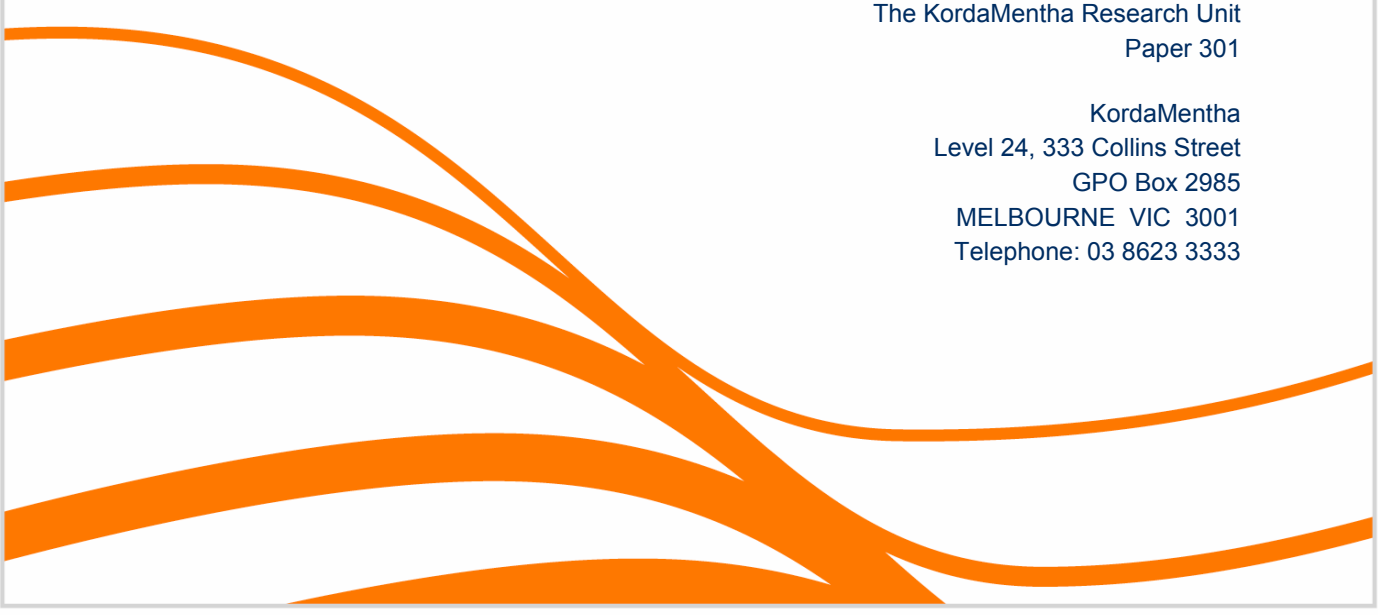

The KordaMentha Research Unit did extensive research on Chapter 11 procedures for airlines and could it have saved Ansett. This is a reprint of an article appearing in the Australian Financial Review 3 June 2003

A spate of large Australian corporate failures has re-ignited debate on Australia's insolvency regulations, particularly the process of voluntary administration.

Also, Qantas has recently referred to the Chapter 11 protection provided to some of its overseas competitors as part of the justification for recent cuts to Qantas staff and other costs in order to maintain the airline's competitive position.

Voluntary administration procedures were implemented in Australia 10 years ago after careful examination of international insolvency precedents, including Chapter 11. The system was reviewed by a Government advisory committee in1998 and, subject to some fine tuning, found to be successful and popular.

Chapter 11, in simple terms, protects a company from its creditors by allowing it, under certain circumstances, to stop creditor payments, while restructuring takes place. Typically management that presides over a company's slide into Chapter 11 is responsible for this restructuring.

Our examination of the Chapter 11 process in the US convinces us that such a system would not have saved Ansett. Moreover, Chapter 11 can be administratively more expensive and it relegates employee entitlements in a way that may not be acceptable in the Australian environment.

Companies in Chapter 11, just like under voluntary administration, need cash and capital to trade during and emerge from Chapter 11. US Airways recently reorganised under Chapter 11 protection. US Airways' exit from Chapter 11 was facilitated by a US$900 million US government loan, the cancellation of all equity, only 2¢ in the dollar to unsecured creditors, US$240 million of equity, an injection of US$100 million of at-risk debt as well as annual wage and benefits concessions from employees of approximately US$1.9 billion a year. Additionally, priority for employee claims under Chapter 11 is limited to US$4,650

With access to these concessions and additional capital, especially US$900 million of government funds, US Airways (or Ansett) could easily have reorganised under Australia's voluntary administration regulations.

Ansett traded for five months under administration. Ansett's trade-on was made possible by, amongst other things, significant EBA concessions, a $150 million settlement with Air New Zealand, federal government underwriting of passenger tickets, the continuing involvement of relevant management, significant cost cutting and fleet rationalisation.

Singapore Airlines and Patrick Corporation both considered recapitalising Ansett. The "Tesna" consortium committed to recapitalising Ansett. However, Tesna eventually chose not to proceed.

Once it was clear that capital was not going to be injected, Ansett was grounded so creditors would get a better result. At that time, Ansett had unsecured assets able to be quickly converted to cash of around $350 million (principally real estate), priority employee entitlements of $735 million and unsecured claims in excess of $2 billion. Without a "white knight" to provide capital the cash would have run out half way through a Chapter 11-style reorganisation.

Chapter 11 regulations and the resultant dilution of priority for Ansett employees would have relegated almost $650 million in entitlements to unsecured claim status. The Federal Government's SEESA and GEERS schemes as well as community expectations to give entitlements priority are evidence of the Australian public's aversion to this US-style solution.

US aviation history is full of "colourful" characters. One oft-cited example is Frank Lorenzo who, as head of Texas International, bought faltering airlines through the 1980's. After stints in bankruptcy with both Continental and Eastern Airlines a US bankruptcy court ruled Frank Lorenzo unfit to run an airline.

With the exception of liability relating to fraud and negligence, US regulations do not incorporate the concept of Directors' liability for insolvent trading or personal liability for Directors, officers or regulators prior to or during Chapter 11.

We examined 19 examples of Chapter 11 filings by large public airlines in the US between 1980 and 2002. The average time in Chapter 11 was 740 days. These examples include companies with multiple filings such as Trans World Airlines (three filings and no longer flying), Continental Airlines (two filings) and Midway Airlines (two filings). US airlines currently in Chapter 11 include United Airlines, Midway Airlines (again) & Hawaiian Airlines.

It is evident from the US aviation experience that a Chapter 11 "solution" is not always enduring. In any event, it is the equity holders, employees and unsecured creditors who fund the Chapter 11 process and who bear significant risk post-reorganisation. Is that equitable?

At Ansett, some of the businesses were sold and continue to operate. Kendell & Hazelton (now Rex), SkyWest, Aeropelican, Show Group and Ansett Cargo were all recapitalised and sold during the Ansett voluntary administration with the approval, in each case, of the committee of creditors.

In the US, Bankruptcy Court approval is required for all major decisions, including asset sales. Court proceedings typically necessitate the appointment and extensive involvement of specialist professional advisers who charge up to US$900 an hour. Court costs and professional expenses rank in priority to other unsecured claims. This level of Court participation in the Ansett administration would have certainly delayed and possibly derailed asset sales. The Ansett administration has however, made twenty applications to the Federal Court. The court is able to supervise voluntary administrations of large complex enterprises, when needed, in a cost effective manner.

International aviation has proven to be a significant risk to capital. Airlines are amalgamated, divested, deregulated and liquidated – when this happens it is unfortunate,

painful and extremely costly for those involved. However, unlike Ansett, it is not a uniquely Australian experience.

Chapter 11 vs Part 5.3A

The September 2003 CAMAC Discussion Paper includes the following comparison between Voluntary Administration and Chapter 11 of the US Bankruptcy Code:

	VA	US Chapter 11
Prerequisites	Insolvency or likely insolvency.	Good faith only.
Who can commence the procedure?	The directors, a liquidator or provisional liquidator or a substantial chargee.	The directors.
Role of the court in commencing the procedure and approving the plan	No mandatory role in either situation, though the court has various ancillary powers exercisable on application.	Procedure initiated by petition to the court. Continuing close court involvement in the rehabilitation procedure, including final approval of plan.
Who controls the company during the rehabilitation procedure	The administrator, who must be a registered liquidator.	The directors (unless the court orders their replacement by an independent trustee).
Committees of creditors	Limited functions, namely to consult with administrator in relation to the administration and consider reports by the administrator.	Major role. Can employ professional advisers at the company's expense.
Information to creditors	Report by the administrator about the company's business, property, affairs and financial circumstances and a recommendation about what is to be done.	Court-approved disclosure statement.
Moratorium on claims against the company	Automatic moratorium, with significant exceptions for some secured creditors and property owners.	Automatic moratorium, which applies to all secured and unsecured creditors.
Ability of creditors to enforce ipso facto clauses	Yes.	No.
Ability of creditors to exercise set-off rights	Yes.	No.
Liability for goods and services	Administrator personally liable, with a right to an indemnity out of the company's assets.	Company liable as debtor in possession, with debts having priority over pre-commencement unsecured debts.
Loan financing during rehabilitation procedure	Lender is an ordinary unsecured creditor of the company.	The court can give a lender a priority over all existing unsecured creditors and, if necessary, over existing secured creditors.

	VA	US Chapter 11
Who devises rehabilitation plan	The administrator.	The directors, usually in consultation with professional advisers, during the exclusivity period (see below). After the exclusivity period, any interested party, including the creditors.
Time to develop rehabilitation plan	Approximately one month, subject to the court extending the period.	Exclusivity period of 120 days.
Approval of rehabilitation plan	One meeting of all creditors.	Meetings of each class of creditors. 'Unimpaired' creditors deemed to have approved plan.
Majority required to approve the plan	50% majority by number and by value of all the creditors who vote.	Two-thirds in amount, and more than one half by number, of creditors who vote, class by class. A dissenting class can be overridden by the 'cramdown' rules.
Rehabilitation plan binding secured creditors	Yes, if the secured creditor agrees or the court so orders.	Yes, provided: • if impaired class of secured creditors, at least one impaired class assents • the plan is fair and equitable.
Rehabilitation plan discriminating between creditors	The creditors can approve a deed that discriminates against particular creditors.	Under the 'absolute priority' rule, senior creditors are paid before junior creditors. All creditors are paid before shareholders. One class cannot receive less than another class with identical priority without the consent of its members.
Time to implement rehabilitation plan	No prescribed limit.	No prescribed limit.

About The KordaMentha Research Unit

Background

KordaMentha partners undertook the first voluntary administration in Australia, the largest voluntary administration in Australia (Ansett with 42 companies, 15,000 employees and >$1 billion assets), the largest group of voluntary administrations in Australia (Stockford with 84 companies) and more voluntary administrations than any other insolvency firm in Australia to date in 2003.

The strength of the KordaMentha experiences and our expertise makes us well placed to monitor and evaluate issues and developments in the insolvency industry and to recommend changes.

Statement of Direction

The KordaMentha Research Unit aims to:

- Develop intellectual property
- Share our knowledge of specialist topics with insolvency stakeholders
- Develop balanced solutions for issues in the industry. We will do this by preparing position papers on topics of interest, and encouraging discussion with a view that changes to the industry will result.

Personnel

The KordaMentha Research Unit is headed by Leanne Chesser. All KordaMentha Partners and Directors contribute to the KordaMentha Research Unit.

Current Research

The KordaMentha Research Unit has conducted research in a number of areas, including:

- 301: Ansett - Part 5.3A and Chapter 11
- 302: Large and Complex Administrations – The Courts and Ansett
- 303: Regulatory Review of Australia's Insolvency Laws
- 304: Employee Entitlements
- 305: Rehabilitating Large and Complex Enterprises in Financial Difficulty