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

27 November 2003

Dear Sir

Rehabilitating large and complex enterprises in financial difficulties - discussion paper

We refer to the Corporations and Markets Advisory Committee ("CAMAC") discussion paper entitled "Rehabilitating large and complex enterprises in financial difficulties" dated September 2003. Thank you for the opportunity for KPMG to provide a submission regarding the discussion paper.

Introduction

KPMG has provided input to the submission to CAMAC by the Insolvency Practitioners Association of Australia ("IPAA") and we generally support the views expressed in that submission. However, we take the opportunity to provide you with our specific comments regarding the following matters.

Informal restructuring

As noted in the IPAA submission, we confirm and reiterate that there has been considerable successful restructuring of large and complex, financially challenged enterprises in this country, where there has been no requirement for imposition of a formal insolvency appointment. In our view, the available balance as between informal restructuring and our current formal insolvency procedures will generally provide the appropriate options, without necessitating the introduction of Chapter 11 style proceedings.

We understand that the CAMAC discussion paper "does not cover informal 'workouts' in the form of voluntary contractual undertakings amongst creditors" (paragraph 0.19), however we believe that the rehabilitation process should be considered against the background of the considerable successes of our current restructuring practices.

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Introduction of a "debtor in possession" regime, similar to Chapter 11 in the United States

We endorse the sentiments of the IPAA, that a Chapter 11 style debtor in possession regime would not be appropriate in Australia. We advance the following in support of this view:

Costs associated with the Chapter 11 regime

- the Court (usually the Bankruptcy Court, to which matters are referred by the federal district courts) is highly involved in a Chapter 11 reorganisation pursuant to the United States Bankruptcy Code. By way of example:
  - the business continues to operate under Chapter 11, but is subject to the protection of the Bankruptcy Court;
  - Court approval is required for any transaction that is outside the ordinary course of business of the debtor;
  - the Court is required to find that the reorganisation plan is feasible and in the best interests of creditors as part of its confirmation;
  - the Court is required to find that the disclosure statement, via which creditors votes are solicited, provides adequate information to the creditors and equity holders;
  - there must be a Court hearing on confirmation of the plan at which any interested party may interpose objections;
  - an order is required to authorise the employment of all attorneys, accountants and other professionals by the debtor, trustee in bankruptcy or authorised committee; and
  - the Court must approve any payment for professional services rendered in a bankruptcy case.
- as a result of this significant Court involvement;
  - Chapter 11 proceedings often involve a very substantial cost; and
  - to introduce this regime into Australia would most probably necessitate setting up a parallel court system (in addition to the existing Court systems) to deal with the large volume of applications required pursuant to such a regime.

Control of the rehabilitation process

- leaving the board of a company in control would probably be repugnant to Australian creditors for the reasons that:
  - it would require them to continue to deal with those with whom they have lost faith and trust;

- it is often difficult to accept that the same management who adopted and implemented the strategies that led to (or failed to prevent) the Bankruptcy of the entity, would then have the ability and preparedness to change strategic direction so as to reinvigorate the company; and
- they may perceive a lack of an independent person involved in the reorganisation as a significant weakness over the existing Australian insolvency regime.

Economic impact

- one of the primary considerations with a rehabilitation or restructuring regime is to avoid it being misused to create an unfair competitive advantage. The best deterrent against such misuse is to take the actual facilitation of the restructuring out of the hands of those who initiate it, namely, the directors;
- we are very concerned that Chapter 11 can be used to support poorly performed companies, to the detriment of the well-managed and efficient industry participants; and
- the imposition of a debtor in possession regime in Australia, without the support of the banking industry, could result in an increase in the cost of credit with consequent adverse impact on the Australian economy.

We believe that the existing voluntary administration ("VA") regime, with certain adjustments, is an effective mechanism by which to facilitate the restructuring of large and complex enterprises and that there is no pressing requirement to implement an Australian version of Chapter 11 for that particular segment of the market.

Specific comments regarding Chapters 1 and 2 of the discussion paper

We highlight the following points arising from Chapters 1 and 2 of the discussion paper where they differ, or have a different focus, from the submission provided by the IPAA:

Paragraph reference	Commentary
1.6	*Prerequisites for initiating the procedure* In our view the existing prerequisite for the implementation of a VA, which requires a company to be either "insolvent or likely to become insolvent at some future time", is appropriate. If stakeholders believe that the company is not sufficiently "financially stressed" or the provisions of Part 5.3A are being abused, they may bring an action pursuant to Section 447A(2). The persons entitled to bring such an action are defined very broadly in Section 447A(4), and include "any other interested person".

Paragraph reference	Commentary
1.39	*Encouraging companies to negotiate with creditors* There can be a clear disincentive for a company to advise its creditors of its financial distress. Those creditors, where they hold security may enforce it, and where they do not, may seek the winding up of the company. It is submitted that the VA regime can provide appropriate scope to deal with these situations in that: ■ a winding up application can be stayed pursuant to Section 440A(2); and ■ a charge, other than a charge over the whole or substantially the whole of the company's assets, may be prevented from being enforced pursuant to Section 441D.
1.56 & 2.82 et. seq.	*Lending to a company in administration* We agree with the IPAA's submission that borrowings by an Administrator should be a personal liability of the Administrator, subject to the Administrator's right of indemnity against the company's assets. However, we emphasise that such borrowings should have no greater priority, through the Administrator's indemnity, than the other personal liabilities incurred by the Administrator. That is, they should not be given a priority over the existing pre-appointment security of a secured creditor. The displacement of pre-existing security may allow a third party to fund a fruitless turnaround attempt and thereby erode the secured creditor's security without its consent.
1.67 & 2.74	*Timetable for completing the procedure* We disagree with the suggestion that creditors should be entitled to extend the convening period for the second meeting of creditors at the first meeting. We suggest that the short timeframe for calling the first meeting can lead to less than complete coverage of all creditors entitled to receive notice of the meeting. Accordingly, the creditors in attendance at the first meeting may not be representative of the full body of creditors and they should not be empowered to extend the convening period, and the consequent moratorium (including the moratorium with respect to directors' guarantees pursuant to Section 440J), without an opportunity for consideration by all creditors. The suggested procedure is clearly open to abuse.

Paragraph reference	Commentary
	As an alternative, it may be appropriate to set the time for the convening of the second meeting based on a threshold asset, liability or turnover test of the entity. In this way, a larger entity, by any of these measures, may benefit from a longer convening period for the Administrator to conduct his or her investigations and then formulate the required opinion as to the most appropriate resolution of the company's position. We are of the view that the US timetable of six months is too long, and imposes an undue restriction on the rights of creditors, particularly secured creditors.
1.71 & 2.176 et. seq.	*Corporate groups* We generally support the submission of the IPAA that corporate groups should be dealt with on a pooled asset and liability basis, provided resolutions are passed by each company's creditors that approve pooling. However, it is submitted that it should not be necessary for every company in the group to be included, as there may be dormant or assetless companies that should be excluded to avoid the time and expense of dealing with those entities. The Administrator should also be permitted to apply to Court to add other corporate entities to the pooled group in voluntary administration where either the creditors of that company failed to pass a pooling resolution or the company has no creditors (provided it has assets and all of its controlling entities are already in VA).
2.25 etc. seq.	*Grounds for appointment* We agree with the IPAA's submission that there should not be a prohibition on directors appointing a Voluntary Administrator where a company is already insolvent. A company with cash flow insolvency can face very different challenges to one with a balance sheet deficiency, and a company with a surplus of assets that is cash flow insolvent may be the perfect candidate for a restructuring through a voluntary administration and a deed of company arrangement. Directors should continue to be entitled to appoint a Voluntary Administrator in these circumstances. In keeping with the objectives stated in Section 435A, the voluntary administration procedure should be available even if there is only a limited possibility of a successful restructuring.

Paragraph reference	**Commentary**
2.39 et. seq.	*The rights of secured creditors in a VA* We strongly disagree with any incursion on the current rights of a secured creditor to enforce its security notwithstanding the appointment of a Voluntary Administrator. In the Australian context, it is highly likely that such incursions would increase the cost and decrease the availability of credit for companies. If a Receiver is appointed by a secured creditor and a satisfactory restructuring plan is later formulated by the Voluntary Administrator, it is already open to the secured creditor to remove its Receiver or otherwise limit the Receiver's powers to allow the restructuring to take place.
2.101 et. seq.	*Voting* We agree with the IPAA's submission that the current voting requirement of a majority of both number and value of creditors be retained. Although those with the largest debts generally have the most at stake, it is submitted that it would be improper to allow them to automatically achieve their preferred resolution in the face of opposition of a majority in number. This would have the potential to undermine the community's perception and acceptance of the VA process.

Paragraph reference	Commentary
2.127 et. seq.	*Voiding antecedent transactions* We agree with the IPAA's submission that the timeframe for a voluntary administration is too short to pursue antecedent transactions. We also submit that it is not appropriate for a Deed Administrator to automatically have the capacity to pursue antecedent transactions during a deed of company arrangement. This is due to the fact that a deed is intended to be an alternative to liquidation and the voiding of antecedent transactions is inherently related to the liquidation of a company. However, we consider it would be appropriate to allow the deed to provide the Deed Administrator with the capacity to pursue antecedent transactions, provided that the creditors approve such a deed and provided that Part 5.7B is included in its entirety. This is to avoid the possibility that, for example, creditors could be exposed to liability for preferences or uncommercial transactions, but directors could be protected from pursuit for insolvent trading. It is submitted, however, that where a liquidation follows the failure and termination of a deed of company arrangement, the three-year time limit in Section 588FF(3) should only commence once the deed has terminated. Otherwise, where a deed of company arrangement operates for a significant period, the Liquidator may face a very short period within which recovery actions must be commenced. The time limit may even have expired prior to the termination of the deed and commencement of the liquidation.
2.207 et. seq.	*Executory contracts* We disagree with the proposal that an Administrator be entitled to unilaterally assign executory contracts. We consider this to be an unreasonable incursion on the concept of privity of contract and freedom of contract.
2.212 et. seq.	*Deed compliance with priority payments* We recommend caution with the suggestion that a deed of company arrangement be permitted to depart from the priorities enunciated in Section 556. In the usual case, the majority in both number and value will be non-priority unsecured creditors. Accordingly, this group would have sufficient voting power to remove the priority Parliament has seen fit to provide certain classes of creditors, particularly employee entitlements.

Paragraph reference	Commentary
2.222 & 2.223	*Solvency under the deed* We disagree with the proposal that a company must be solvent either at the time of commencement or the time of termination of a deed of company arrangement. One of the key aims of Part 5.3A, pursuant to section 435A, is to provide a better return than would be available in a liquidation, regardless of the solvency of the company.
2.236	*Committee of creditors* We suggest that there should be a limit on the size of a committee of creditors. In our experience, large committees can become unwieldy and are of limited effectiveness. It appears reasonable to limit the membership of the committee to a maximum of around twelve members. However, it would also be prudent to allow the Administrator the discretion to increase this number in an appropriate case. For example, where it is a particularly large corporate entity or group structure and there are a large number of distinct creditor groups, than the Administrator could allow in increase in the permitted maximum number of committee members to allow for proper representation of the creditor groups.
2.238	*Exchange listing* We agree with the submission of the IPAA that companies subject to voluntary administration should not continue to be traded on the Stock Exchange. In addition to the comments made by the IPAA, we note that there is a cost involved in tracking transfers of shares. It is not clear who would be required to pay for this where a company is in voluntary administration. As there is no benefit to creditors in these transactions occurring, the creditors should not be required to meet these costs from their entitlements to the company's assets.

Should you have any queries regarding our submission, please feel free to contact Mr Stephen Hawke on telephone number (03) 9288 5827.

Yours faithfully

S A Hawke
Partner