CAMAC DISCUSSION PAPER

REHABILITATING LARGE AND COMPLEX ENTERPRISES IN FINANCIAL DIFFICULTIES[1]

SUBMISSIONS of R W HARMER[2]

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Chapter 1.

1. On the 'definition' of 'large and complex' companies

Any definition would be most problematic. I am not aware of any modern system that creates such a division.[3] Further, I do not think it may be suggested that ALRC45 promoted any or any significant divide between small, medium and large. That was certainly not the intention of paragraph 57 of that report. Rather it was designed to preserve schemes of arrangement as possibly having a place for larger companies, particularly if, as noted in the report, a reorganisation might involve the creation or application of some form of exotic corporate product.

2. On the initiating test

The assessment (1.12-1.14) seems to state the reality, namely that the existing financial stress test is probably not all that different to the US 'good faith' test. I would not see any advantage in adopting the US test (except such advantages that might be produced by unnecessary litigation).

3. On control

There are a number of brief points to make:

- The debtor in possession approach requires, ultimately, the engagement of professional advisers by the debtor. That is a simple fact. Very few, if any, successful cases of Chapter 11 have been done 'in house'.[4]

- It may appear that a greater range of expertise may be summoned and employed under the US system. But under the Australian system there is nothing to prevent an administrator from engaging industry and other experts

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[1] I should observe at the outset that this Discussion Paper and also the Inquiry by the Parliamentary Joint Standing Committee into the insolvency laws are to be applauded, coming as they do some 10 years following the major insolvency law reforms of 1993. That indicates an ongoing test and examination of the laws and their application – a good approach to good health.

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[3] The insolvency laws of some countries in transition create divisions between various forms of enterprise, but they are largely irrelevant to this debate.

[4] Except where the reorganisation is, in effect, the product of a management buy out and even then that usually involves a host of financial and other consultants.

in particular cases. And ALRC45 recommended[5] that the field for eligibility as an administrator be greatly widened.

- The 'control' factor may, therefore, be illusory – what is wanted is expertise and someone capable of cutting a deal.

- If it considered that, having now had the benefit of a relatively free flowing experience under voluntary administration, the commercial community in Australia is ready to move to a less controlled position, then I would not be opposed to it.[6] But I would suggest that the directors of a company be given an option – either they go it alone and take the consequence of that or they appoint an independent administrator. The results of that experiment might be very interesting. And there might have to be some rapid change to the law concerning the liability of a director.

4. Negotiation with creditors

I would be quite happy to see the restraints on creditors strengthened and follow the latest UK trend – although it is quite clear that the reaction of floating charge holders in Australia to administration has not been anywhere near as evident as it has been in the UK.[7]

5. Ongoing financing

I accept that the Australian regime could benefit from a more 'codified' approach in this area

6. Equity finance

I do not understand the concern regarding this nor the suggestion that some specific provisions might be required. Is it not similar to 'debt trading'? You buy the debt and start influencing the outcome of the rescue. Then you engineer a debt for equity swap or offer to pump in some new equity and etc. Alternatively you simply acquire existing shareholder rights (or a fair % of them) and start horse-trading with the creditors/administrator.

7. Timetable

It would be very remiss, in my opinion, if time periods were greatly extended. I have had first hand reports of some dreadful instances in the US of time dragging to eventually wear down the opposition (possibly brought about by the behaviour of some US judges who give as much time latitude as possible so that they can notch up yet another 'successful reorganisation' on their record).

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[5] Paragraph 937

[6] But see my later comments under 8 below.

[7] The most recent of the UK reforms also signals the gradual demise of the floating charge for reasons unrelated to insolvency. There is a reasonably reliable body of opinion in the UK that the existing secured transactions regime, if it can be called such, will be soon abolished and replaced by a system that is more aligned to practices in the US and western Europe.

8. Generally

Although I have responded to a number of the issues raised in Chapter 1 without questioning why the issues are raised, I must still question what appears to be an underlying assumption or suggestion to the Discussion Paper; namely, that somehow, someway, some one, two or more of the larger corporate insolvencies in Australia might have been better handled and might have produced a better result if the Australian regime was more like the US Chapter 11 regime. To that I simply pose the rhetorical question: what is the basis for that contention? Hopefully the Committee will receive some detailed submissions directed toward providing an answer to that question which I will be most interested to see.

On another, more general matter, it maybe worthwhile to consider the US system as a broad integrated system: each component part is essential and only together do they make a workable whole.[8] Viewed in that light, it seems to me that it would be difficult to cut and paste a part or parts of the essential components of the Chapter 11 system to the Australian system. For example, assume that the debtor in possession mode was adopted in Australia without much or anything else. It must then follow that the debtor (or its advisors) would have the first (or, at least, one) bight at the preparation and presentation of a plan. Creditors will then realise that they need independent advisors to assess and quarrel with the proposals of the debtor because they have not got the facility or the luxury of an independent administrator. Next the creditors will realise that there are different interests represented within their number. So they will split into classes, each separately advised. Then it will become apparent that arguments and disputes will have to be solved. So the court will have to be given a far more interventionist role (not to mention the lawyers that will have to be engaged) and a final approval or sanction power. One thing produces another and you end up with a de facto Chapter 11 system. If that is right then it suggests to me that either something like the Chapter 11 system must be adopted as a whole, or not at all.[9]

Chapter Two[10]

1. Initiation and administration

If considered necessary I would support the options set out in 2.28 and 2.32.[11] I would give some support to 2.34, but with the pragmatic rider that in my experience in countries where creditors are permitted to initiate rescue attempts, very few, if any, rescue attempts are in fact initiated by creditors.

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[8] In much the same way as the Australian system may be similarly viewed.

[9] This is not to suggest that certain features of Chapter 11 should not be considered, such as a greater restraint on secured creditors, avoidance of ipso facto clauses and the like.

[10] The following comments on this Chapter should be regarded as of general application and should not be treated as directed at administrations in respect of 'large and complex' corporations.

[11] Perhaps the problem of the corporate group might be solved by a provision that required one or more of the companies in the group to meet the basic 'financial' test and that the survival of the vital components of group as a whole would be best facilitated by all the companies in the group initiating voluntary administration.

2. Eligibility

I would promote the original recommendations in ALRC45.

3. Overriding rights/partial exercise

As mentioned earlier, I would support removing the power of any secured creditor to intervene in a voluntary administration.

4. Timing

I would support something like the option set out in 2.71.

5. Notification

I suppose eventually we must all accommodate modern methods of communication and I would not be opposed to specific rules enabling notices and the like to be communicated by methods other than through the use of the postal services.

6. Lending

As mentioned earlier, I would support a more 'codified' approach to this issue that, in effect, created a 'super priority', but which was at all times subject to resolution between existing secured creditors (where their security might or could be impaired), the new credit provider and the administrator, with the court available in the event of dispute. But that does not seem to fall squarely within any of the policy options mentioned in the Discussion paper

7. Voting/casting vote

This is the age-old problem. No system is perfect, but, on reconsideration, I doubt that the recommendation in ALRC45 (the court) is the answer. I do not imagine that a judge would welcome the opportunity to make such a decision. Maybe the answer lies in giving a casting vote to an independent chairperson.[12]

8. Remuneration

I would not have a problem with 2.117.

9. Indemnity

The option in 2.125 would solve this issue.

[12] This might perhaps herald the beginnings of a new profession – professional chairpersons.

10. Avoidance

I do not think ALRC45 went quite that far. As I recall, the 'standard' terms and conditions to be incorporated into a deed of company arrangement, as drafted in Vol.2 of ALRC45, provided for a possible 'opt-in' of the avoidance measures.

11. Equity/debt swaps/prospectus disclosure/financial product disclosure/takeover provisions

I should refrain from offering any comment on these since they are outside of my current understanding and knowledge. But I might mention that ancillary legislation in the USA bankruptcy Code is specifically directed at some of the above areas in an effort to better promote a deal.[13]

12. Court directions

I agree with the comment in 2.167

13. Set off

This must and should continue to be permitted, unless one wishes to endanger a large number of financial products.

14. Pooling of assets

I think the thrust of the submission to CAMAC as mentioned in this part has considerable merit.

15. Ipso facto clauses

I would support avoiding the lot. Even tough it does intervene upon contractual rights, no great damage is likely.

16. Executory contracts

In my opinion providing for a unilateral power to assign is one bridge too far. That really does start to interfere with fundamental contractual rights

17. Priority creditors

I think that the present position is the most apposite.

18. Employees generally

From this distance I do not feel competent to comment on the good sense or otherwise of the interventions of government into the position of employees,

[13] See 11 USC, paragraphs 1145-1146 (1994)

although it might be nice to one day see some development of an overall sound policy instead of what appear to be a series of reactions.

I refrain from commenting on the remaining issues.

I mention that I have given evidence to the Parliamentary Committee Inquiry into the Insolvency Laws, some of which might be relevant to CAMAC. I understand that will be available on the parliamentary website in due course.

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