KordaMentha

PO Box 3185
East Perth WA 6892

Level 10
40 St Georges Terrace
Perth WA 6000

+61 8 9220 9333
info@kordamentha.com

Manager
Market Conduct Division
The Treasury
Langton Crescent
PARKES ACT 2600

10 September 2021

By email: MCDinsolvency@treasury.gov.au

Dear Sir/Madam

Improving schemes of arrangement to better support businesses

This submission is made by KordaMentha. KordaMentha is an advisory and investment firm that helps clients to grow, protect and recover value. KordaMentha is leading restructuring firm in Asia Pacific with experience across both voluntary administrations and schemes of arrangement.

This submission supports the position outlined in the submission of the Australian Restructuring Insolvency and Turnaround Association ('ARITA') dated [xxx September 2021]

We have had recent experience on several schemes of arrangement including:

Boart Longyear Limited ('Boart')

- Independent expert report for two schemes of arrangement between Boart and its senior financiers (Secured Scheme and Unsecured Scheme) in 2017.

Quintis Limited ('Quintis')

- Voluntary administrators and subsequently deed administrators.
- Independent expert report for scheme of arrangement between Quintis and its financiers.

From this experience outlined above, we have provided responses to each of the questions in the consultation paper in Appendix A.

Yours faithfully

Mark Korda
Partner

Appendix A

Question from discussion paper	KordaMentha comments
Question 1: Should an automatic moratorium apply from the time that a Company proposes a scheme of arrangement? Should the automatic moratorium apply to debt incurred by the Company in the automatic moratorium period?	The majority of Schemes relate to the reorganization/compromise of the debt capital structure. It is not clear whether the proposed moratorium would apply to all debts or just to the debts of scheme creditors. We suggest it be applied just to scheme creditors (i.e. creditors who are going to be compromised by a scheme). To apply this to all creditors may make the process unwieldly and have negative reputational/trading consequences. If the moratorium was to extend to all creditors, there needs to be clarity around security of payment of debts incurred by the company during the moratorium. These debts should be paid on a BAU basis and have some priority if the scheme fails/company fails. Without an appointed insolvency practitioner with personal liability, there is no guarantee of payment in an insolvency, and it is unclear whether creditors would continue to supply through a moratorium period. We think creditors would put the company on COD basis which could further exacerbate any liquidity issues. For example, when we were Scheme Administrators on Boart Longyear, the form 505 was lodged and this caused a number of operational issues with creditors (who were not part of the scheme) becoming aware of the scheme and becoming concerned about future supply.
Question 2: Would the moratorium applied during voluntary administration be a suitable model on which to base an automatic moratorium applied during a scheme of arrangement? Are any adjustments to this regime required to account for the scheme context? Should the Court be granted the power to modify or vary the automatic stay?	See comments above. Court control over the continued operation of the moratorium should be used so creditors are not unfairly treated.
Question 3: When should the automatic moratorium commence and terminate? Are complementary measures (for example, further requirements to notify creditors) necessary to support its commencement?	A moratorium could commence once court documents are lodged; prior to this time may be pre-emptive as the public nature of the 'announcement' could frustrate the attempts to agree a scheme. Further, if an earlier moratorium was to come into place, the process could be subject to abuse by companies and frustration of creditor rights. Consideration could be given for a moratorium being given when there is support for the process by 50% of creditors in value so as to avoid abuse or frustration of creditors rights by a Company proposing a Scheme that does not have the support of its stakeholders. Any moratorium would need to be communicated to creditors.
Question 4: How long should the automatic moratorium last? Should its continued application be reviewed by the Court at each hearing?	The length of the moratorium should be dependent on the scheme requirements. The Board should be required to form an opinion that the Scheme is likely to be successful, and it remains a better outcome for each class of creditors. Creditors should also be able to be heard as part of the court process to object to the continuing moratorium, to protect their rights. At each court hearing, there should be consideration of whether the moratorium should continue or cease.

Question from discussion paper	KordaMentha comments
Question 5: Are additional protections against liability for insolvent trading required to support any automatic moratorium?	It seems appropriate that safe harbour protection be available simultaneously, so long as the safe harbour hurdles are met. However, consideration should be given to how this impacts on creditors that are bound by the moratorium. Creditors should not be at risk for debts incurred during the moratorium period, so consideration is required on how these creditors should be protected.
Question 6: What, if any, additional safeguards should be introduced to protect creditors who extend credit to the Company during the automatic moratorium period?	Consideration of making this funding super priority (similar to personal liability of administrators) should be given. However, this needs to be weighed up when considering how this interplays with secured creditors and their rights.
Question 7: Should the insolvency practitioners assisting the Company with the scheme of arrangement be permitted to act as the Voluntary Administrators of the Company on scheme failure?	No, they should not. They would effectively be reviewing their own plan and assessing it. Similar scenario to safe harbour advisor becoming VA.
Question 8: Is the current threshold for creditor approval of a scheme appropriate? If not, what would be an appropriate threshold?	Consider majority approval by each creditor (and, if relevant, shareholder) class, aligning the scheme process with the voluntary administration/DOCA approval thresholds. However, for financier creditors, an effective 50% drag along would seem to impinge on their rights to a large extent and could make financing difficult to obtain/more expensive. Therefore, for secured creditors, we believe the current voting thresholds should remain.
Question 9: Should rescue, or 'debtor-in-possession' (DIP), finance be considered in the Australian creditors' scheme context?	DIP funding should be considered. However, the impact on secured creditors' rights should be considered. At a minimum, existing financiers should be given the opportunity to provide DIP funding. Concern is there will be aggressive lenders advancing DIP funding to gain control of an asset as a loan to own strategy.
Question 10: What other issues should be considered to improve creditors' schemes?	N/A