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Rehabilitation regime or corporate graveyard: practitioners' perspectives of the Australian Part 5.3A Voluntary- Administration Legislation

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Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspectives of the Australian Part 5.3A Voluntary-Administration Legislation

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Thesis Certification

I, Michael J. Blazic, declare that this thesis, submitted in partial fulfilment of the requirements for the award of Doctor of Business Administration, in the Faculty of Business, University of Wollongong, is wholly my own work unless otherwise referenced or acknowledged. The document has not been submitted for qualifications at any other academic institution.

Michael J. Blazic

18 February 2014

For Grandpa Kim and Grandpa Blazic.

Without the inspiration of these two remarkable men, this journey would not have started, and it saddens me that they are not here to share its end.

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Abstract

Corporate restructure is pivotal to the efficient operation of Australia's economy, including the ability for companies to respond to a dynamic macro environment and the productive utilisation of market capital. The ability of a distressed company to effectively and efficiently restructure has significant implications for stakeholders, employment, productivity, enterprise value and the community. The present research attempted to understand the ways in which the current insolvency framework - and in particular the Part 5.3A voluntary administration legislation - is experienced by experts in the field, with a view to identifying ways in which it may be developed. The methodological approach was a qualitative study utilising semi-structured interviews with 15 insolvency practitioners to gauge a deep understanding of the research questions. Findings indicated that there was broad based support for the effectiveness of the current legislative framework, however eight recommendations were drawn from the themes identified in the analysis to facilitate improved insolvency outcomes. These recommendations encompassed refinements to the existing legislation, reassessment of the policy and regulatory environment in which the legislation operates, and the broader development of a framework conducive to facilitating a corporate rescue culture. The present research reiterates the criticality of an effective corporate restructuring framework for the efficient operation of the Australian economy and to facilitate the rehabilitation of companies with viable underlying businesses as a matter of course.

CHAPTER 1: INTRODUCTION

RESEARCH CONTEXT

In 2013, over 10,000 distressed Australian companies entered into external administration (ASIC, 2014); their downfall was associated with poor returns, loss of employment and the destruction of value and livelihoods. How corporate restructuring takes place thus has significant implications for the Australian economy and workforce. In acknowledgement of the widespread economic and social implications of insolvent companies, legislation was introduced in Australia in the early 1990s to provide a mechanism to restore a company to financial health and provide an improved return to creditors. This framework, called voluntary-administration, was introduced under Part 5.3A of the Corporations Act.

The recent cycle of economic volatility has its genesis in what has become known as the Global Financial Crisis (GFC), which had widespread effects on the Australian economy. Along with deteriorating levels of Gross Domestic Product (GDP), the local equities market dropped by 54% from its peak in 2007, unemployment increased by 2%, credit spreads rose and liquidity in the market rapidly contracted (Reserve Bank of Australia, 2008). Within this global economic context and ongoing financial uncertainty, effective insolvency legislation, and the capability to successfully restructure distressed companies it provides, has never been more relevant. There is particular evidence for this in regions most heavily affected since the GFC, such as Europe, where the significant number of insolvent companies has highlighted the

shortcomings of the existing, and somewhat timeworn, rehabilitation framework. Even in healthier economies such as Australia's, the need to evolve and re-shape the corporate-insolvency framework remains critical to the viability of a healthy economy and to withstand the threat of financial shock, such as that experienced during the GFC.

It is thus important that distressed Australian companies with viable underlying businesses are restored to financial health as a matter of course. Currently, only a minority of these companies are being saved. The present thesis constitutes an attempt to understand how insolvent companies are currently handled and rehabilitated, with a view to understanding how corporate restructuring can be better facilitated. It also seeks to examine in depth the recent calls to shift the insolvency framework away from a creditor-outcome-focused path, with an emphasis on punitive regulatory enforcement, to a greater focus on corporate rescue and saving companies. The research also considers the relationship between an increased likelihood of business survival and viability, on the one hand, and improved outcomes for stakeholders and more efficient use of capital in the market, on the other.

RESEARCH AIMS

The present study seeks to examine the practical perspectives, experiences and views of registered and official liquidators and insolvency lawyers (together termed "insolvency practitioners"). It uses a qualitative methodology to gain an in-depth understanding of the effectiveness of, and barriers to working within, the existing Australian corporate-rescue framework. The research examines insolvency practitioners' views on the practical significance and implications of key legislative differences between the

Australian Part 5.3A legislation and alternative frameworks, both conceptual and those from overseas jurisdictions.

The following research questions are embedded in assumptions of an economic and social nature. These assumptions reflect the policy environment of the time, with the underlying insolvency principles in the Australian setting outlined in the aims of the Harmer Report (1988). These aims are particularly relevant given the absence of a developed theoretical perspective on corporate insolvency in Australia (Symes, 2008). The present research questions contemplate the theory of value maximisation (Eow, 2003) in the context of corporate rehabilitation, and the equitable value redistribution to stakeholders in considering the optimal insolvency outcome. The theoretical framework underpinning contract law is also used to inform the research questions insofar that the operation of creditor and debtor rights are founded in the underlying contractual relationship itself.

The specific research questions to be addressed in this thesis are as follows: -

1) How do insolvency practitioners in Australia perceive the Part 5.3A legislation, and what are their views on its effectiveness?
2) What factors account for the relative decrease in voluntary-administration as a means of handling insolvent companies?
3) What are the barriers in practice to the effective rehabilitation of insolvent Australian companies as a matter of course?

4) How can we improve the mechanisms and effectiveness for insolvent companies to be restored to financial health, and what value might this have for a reconsideration of the Australian framework?

It is hoped that by developing an in-depth understanding of the constraints of restructuring in practice, this study will contribute to furthering the Australian corporate-rescue framework. This thesis begins with a review of the literature and a discussion of the current knowledge regarding corporate rescue in Australia. Chapter 3 presents the way in which the research was conducted, and describes a qualitative methodology and the use of semi-structured interviews to gain in-depth information from participants about their views and experiences with insolvent companies. Chapters 4 and 5 present the findings from this research, and Chapter 6 discusses the major implications and considerations for future directions.

CHAPTER 2: A REVIEW OF THE LITERATURE

INTRODUCTION

The main focus of this literature review is the legislative framework forming the mechanism for the corporate restructuring of companies in Australia. From a historical context, the beginnings of an Australian corporate-rescue framework that was aimed at rehabilitating distressed companies were adopted from the UK scheme of arrangement procedures. In 1993, in response to the findings and recommendations of the Harmer Report (1988), the Part 5.3A legislation was introduced, along with other significant reforms to Australia's legislative framework on insolvency, under the *Corporate Law Reform Act 1992* (Cth). Whilst the Harmer Report (1988) recommended the adoption of a voluntary-administration regime of corporate rescue to operate in conjunction with the existing scheme of arrangement provisions, until recently the latter has largely been rendered redundant for insolvent companies. The Part 5.3A framework has largely replaced schemes of arrangement, and through the deed of company arrangement has become the prevalent procedure, permitting a compromise or arrangement binding on all its creditors and implementing a rescue strategy (Insolvency Practitioners Association of Australia, 2009).

Whilst in Australia the scheme of arrangement legislation continues to remain available, the regime has been described as cumbersome, slow and costly (Harmer Report, 1988). With substantial costs for even relatively simple schemes, and the time required for scheme implementation often exceeding 6 to 12 months, the regime is particularly

unsuited to the average distressed company (Harmer Report, 1988). Furthermore, a significant problem inherent with schemes of arrangement is the ongoing insolvent-trading obligations of company directors, which effectively prevent borderline solvent companies from continuing to trade whilst restructuring. For these reasons, this research will focus on the Part 5.3A legislation in examining the Australian restructuring model available to distressed and insolvent Australian companies, and compare it to alternate frameworks including those used overseas. Against this backdrop, this research will also seek to understand the rationale and drivers of the recent reappearance of the scheme of arrangement legislation for very large distressed companies in Australia, and consider the implications this has for the broader corporate-rehabilitation landscape.

Significantly, Australia has never had a separate insolvency statute, as its corporate insolvency legislation has been incorporated within Chapter 5 of its general company legislation, now known as the *Corporations Act 2001* (Cth). The objectives of the legislation followed recommendations contained in the Harmer Report (1988) to implement an Australian regime to help distressed companies restructure themselves that was efficient, uncomplicated, flexible, cost-effective and, to a significant degree, free from judicial interference. The legislation outlines the object of Part 5.3A voluntary administration in a general provision under s 435A *Corporations Act 2001* (Cth):

> The object of this Part is to provide for the business, property and affairs of an insolvent company to be administered in a way that:
>
> maximises the chances of the company, or as much as possible of its business, continuing its existence; or

> if it is not possible for the company or business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company.

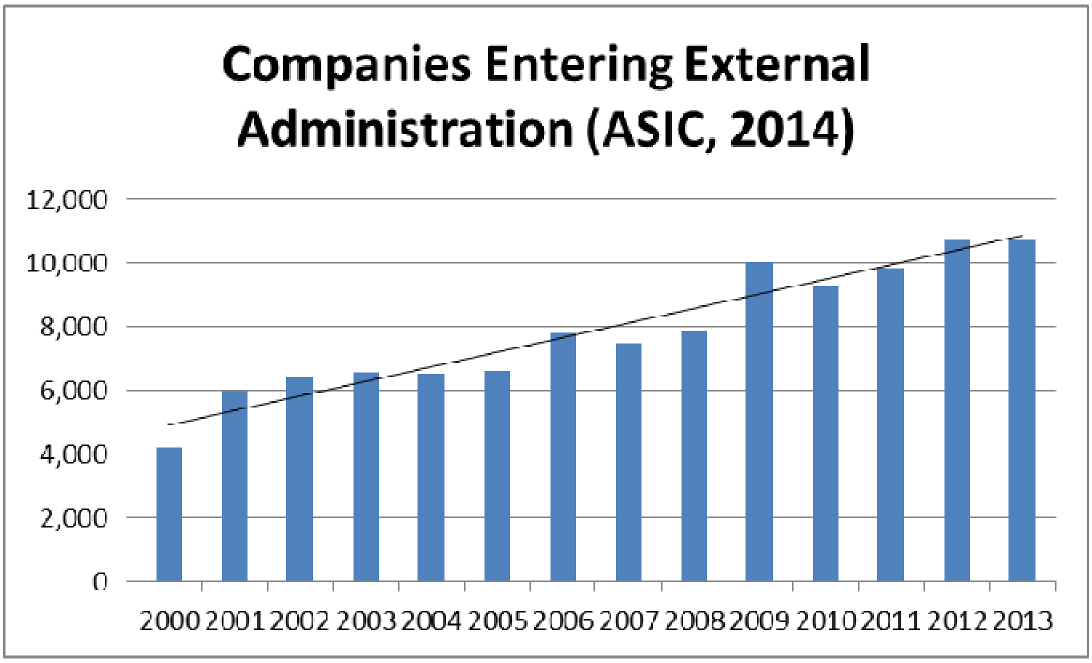
The backdrop of the Harmer Report was premised on a number of high-profile corporate collapses in the 1980s. This included companies such as Rothwells Merchant Bank, Qintex, Hooker Corporation, Bell Group and Bond Corporation; their demise, among others', providing the impetus for a constructive approach focused on company preservation. The fundamental objective of voluntary-administration is to rescue viable companies from being wound up, where the threat of insolvency would otherwise likely result in steps being taken by creditors to place the company into liquidation. Through the successive cycles of recession experienced in the late 20th century as a catalyst, and the corresponding high levels of individual and corporate failure, Part 5.3A was devised to facilitate corporate rescue. The benefits of facilitating this rescue process and enterprise continuation represent a potentially tangible upside to stakeholders of the company, including preserving employment, enterprise value and existing business synergies for creditors (particularly unsecured) and members (Fridman, 2003). The procedure provides an attractive alternative solution to the often inevitable poor returns and devastating value destruction resulting from winding up a company through liquidation, and the wide-ranging socio-economic welfare repercussions. Indeed, the social and economic impact of corporate collapse, including unemployment, the destruction of knowledge and management expertise, and the impact on the promotion of innovation, should not be underestimated (Merrett, 2003).

Through this voluntary-administration process, particularly where a deed of company arrangement is entered into, there exists significant flexibility in achieving required restructure outcomes. The voluntary-administration regime is effectively a formal moratorium-type administration, which seeks to facilitate a unique stay on creditor actions. This provides an opportunity for a company to restructure, thereby increasing the likelihood of saving the company from liquidation and producing a situation ultimately beneficial to creditors and other stakeholders. The deed of company arrangement process can be used to achieve a wide spectrum of arrangements specific to the distressed company's requirements. This may include a simple compromise of debts, complete corporate restructure, capital raising or a moratorium followed by resumption of normal business operations. It seeks to strike the fine balance between making the legislation sufficiently attractive to facilitate a corporate-rescue culture, without making the procedure susceptible to abuse by short-circuiting ordinary safeguards (Fridman, 2003). Furthermore, it is well recognised that unsecured creditors generally receive minimal to no benefit from liquidation, and in that regard bear significant financial burdens from insolvency (Lipton, 1993). An effective rescue regime requires the balancing of stakeholders' various and often-disparate interests, particularly those of creditors. Through this creditor-focused process of obtaining approval for rehabilitating the distressed company, Part 5.3A seeks to provide a "rescue based legislative environment [where] voluntary-administration is the means, corporate restructuring is the end" (Sloan, 2008b, p6).

IMPORTANCE OF A CORPORATE-RESCUE FRAMEWORK

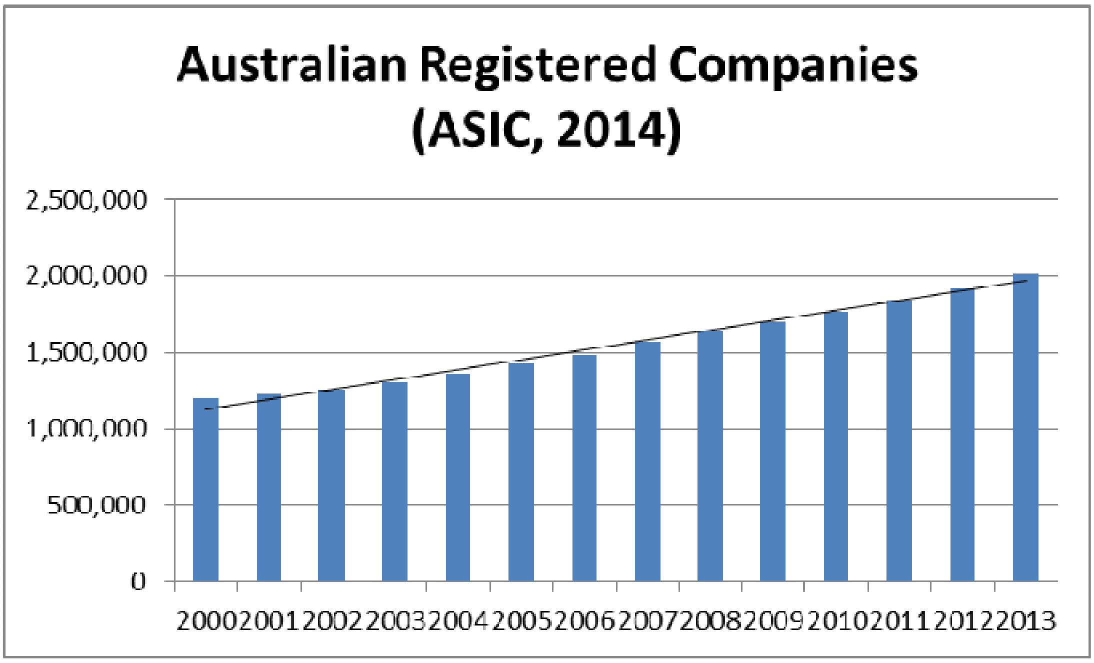
The significance of an effective corporate-rescue framework is highlighted by the continued record high levels of 10,746 Australian companies that were placed under external administration in 2013, representing a staggering 156% increase since 2000. Figure 1 shows the number of companies entering external administration over the 13-year period between 2000 and 2013.

Figure 1: Number of Australian Companies Entering External Administration



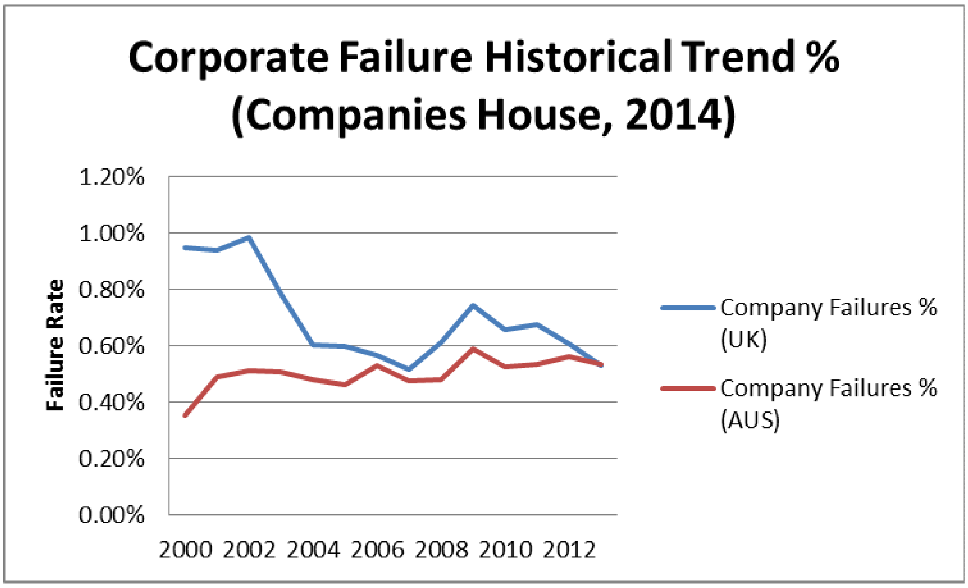
The significance of this growth is particularly highlighted when contrasted to the 68.2% growth recorded in the number of registered companies in Australia over the same 13-year period; from 1,196,114 to 2,012,241. Figure 2 shows the number of Australian registered companies between 2000 and 2013.

Figure 2: Number of Australian Registered Companies



This translated into the corporate failure rate of Australian companies deteriorating from 0.35% of registered companies at the turn of the century, to 0.53% by 2013. In a broader global context, this can be contrasted to improving corporate failure rate trends in other comparable jurisdictions such as the UK, albeit trending from a higher base. From a UK insolvency framework perspective, failure rates over the period have seen an improvement from 0.98% to 0.53%, with notable advancement following the introduction of the Enterprises Act 2002. Similar statistical comparative data for benchmarking from a US Chapter 11 context is unfortunately constrained by the limitation on statistical data relating to US corporations due to registration being the responsibility of state governments, with requirements and reporting varying according to state law.

Figure 3: Corporate Failure Rate Historical Trend



Under the *Corporations Act 2001* (Cth), Australia has a three-tier insolvency regime for companies entering external administration, broadly broken down as follows:-

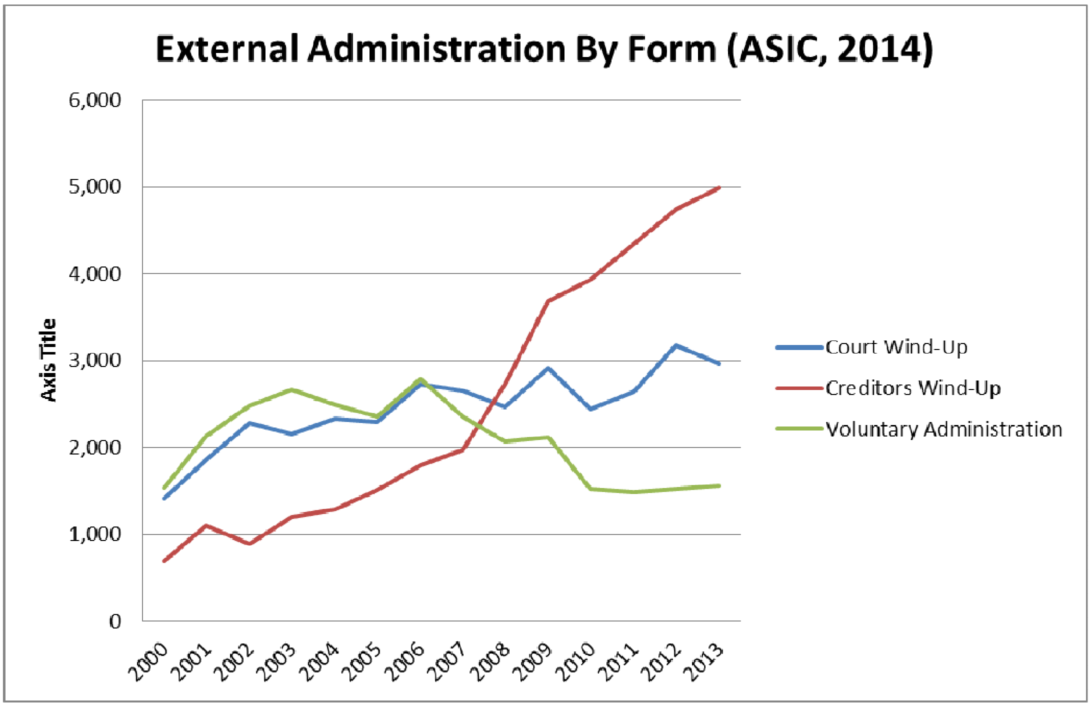
1) Liquidation (creditors' voluntary and court appointed);
2) Voluntary-Administration (Part 5.3A); and
3) Receivership (secured creditor or court appointed).

Available empirical research data suggests that, of the companies entering external administration under voluntary-administration, fewer than half were successful in rehabilitating under the procedure. This in turn caused creditors to incur unnecessary costs pursuing the prospect of rehabilitation, only to discover that any reorganisation proposed was not viable (Routledge, 1998). These statistics formed the impetus for the changes to Australia's insolvency legislative framework contained in the *Corporations*

Amendment (Insolvency) Act 2007 (Cth), with the aim being to facilitate the easier entry of distressed companies directly into the creditors' voluntary-liquidation process (which will be discussed further below). This effectively removed the role of the Part 5.3A legislation as an "appointment mechanism" for companies without ongoing viability or the prospect of restructure, prior to proceeding to the dissolution of non-viable companies through liquidation (Bickerdyke & Ors, 2000). These amendments streamlined the existing procedure for creditors' voluntary liquidation, removing the requirement to hold the members and creditors meeting on the same day and requiring the appointed liquidator to convene the meeting of creditors. These changes were also implemented to provide a safeguard to ensure that only those companies with a real potential of successful rehabilitation or realisation of improved creditor returns compared to liquidation would use the voluntary-administration procedure.

Further analysis of the trends in external administration type by form indicate that the prevalence and use of the voluntary-administration procedure has been diminishing against the backdrop of increasing Australian insolvency trends. Figure 2 demonstrates that 'court wind-up' and 'creditor wind-up' have now surpassed administrator appointment as the preferred insolvency procedure in Australia.

Figure 4: Number of Australian Companies Entering External Administration by Form



This rapid decrease since the introduction of the *Corporations Amendment (Insolvency) Act 2007* (Cth) has seen voluntary-administration fall to the third most popular insolvency procedure used by distressed companies in Australia. This relegation of the corporate-rehabilitation framework poses potentially significant questions around the existence of a corporate "rescue-based" culture in Australia, with just under one in six insolvent companies using the voluntary-administration procedure in 2013. A potential mitigation to the significance of this deterioration in the popularity of the voluntary-administration process is the extent to which the above statistics represent changes preventing unmeritorious use of the procedure. The question, therefore, is whether the amendments under the *Corporations Amendment (Insolvency) Act 2007* (Cth) now reflect an improved ability for selection of the most effective regime for the distressed company. That is, do they maximise stakeholder benefit whilst remaining careful to

ensure that the rescue goal is not inefficiently or fruitlessly pursued to the detriment of all stakeholders?

Rescue Culture – the Australian Context

Following the recent economic instability seen during the GFC and financial-market turbulence relating to the ongoing European Sovereign Debt Crisis, the importance of a strong rescue framework in Australia has never been more relevant. Recent statistics indicate that in Australia during the depths of the GFC, "the value of new asset impairment charges of the banks more than tripled in the year to September 2008 to $13.3b" (www.restructuringworks.com.au). Such statistics have focused the spotlight on the current Part 5.3A legislation as the mechanism responsible for facilitating the survival and restructure of distressed companies. Empirical research into voluntary-administration shows that creditors generally receive a better return under the procedure compared than with immediate liquidation, with one study finding that the average return is up to five times higher (Routledge, 1998). This increasing recognition of the linkage between enterprise continuity and the impact of failure on stakeholders includes the important role companies play in ensuring the continued economic prosperity (or otherwise) of a nation's economy:

> We support a change to the laws which would make our insolvency laws more focused on reconstruction like the United States Chapter 11 process…one of the most admirable things about the United States is that their economy or industries appear to hit a brick wall and then restructure and then they're back in the race again…and I think that is partly due to the way in which their insolvency laws operate. (Turnbull, 2009)

The Part 5.3A Procedure

The platform for Australia's corporate-rescue and rehabilitation legislation is outlined in the *Corporations Act 2001* (Cth), with Part 5.3A titled "Administration of a company's affairs with a view to executing a deed of company arrangement". The benefit of the voluntary-administration framework in this context is that it provides an effective means of assembling the distressed company's creditors to potentially obtain approval for a means of rehabilitating the company. This process can occur without the need to negotiate with each creditor individually, whilst having the benefit of being binding on all creditors without the requirement of unanimous approval.

The commencement of the voluntary-administration procedure can be initiated by three groups of stakeholders, facilitating corporate rescue without court involvement. These stakeholder groups include the directors of the company as set out in s 436A *Corporations Act 2001* (Cth), the liquidator or provisional liquidator of the company (s 436B), or a secured creditor holding a charge over the whole (or substantially the whole) of the company's property (s 436C). These critical features of a cost-effective and speedy process are founded in the recommendations of the Harmer Report, 1988, which advocated that the procedure be "primarily designed to enable a company to deal with its insolvency on its own initiative". The Australian legislation is structured to facilitate - to the extent possible - incentives for the board of directors to use this corporate-rescue procedure where the company is facing genuine insolvency or the risk of it (Fridman, 2003). Primary amongst these incentives is the insolvent-trading regime (s 588G) and available defences (s 588H). From the perspective of the company's directors, the underlying aim of this process is to provide an efficient mechanism for

directors to transition to external administration upon the company becoming insolvent (Anderson, 2001). In fact, under s 436A, all that is required to appoint an administrator is a board resolution that states: "(a) in the opinion of the directors voting for the resolution, the company is insolvent, or is likely to become insolvent at some future time; and (b) an administrator of the company should be appointed". Section 95A of the *Corporations Act 2001* (Cth) defines an insolvent company on the basis that it is unable to pay all its debts as and when they become due and payable. Upon appointment of the administrator, the company's board of directors continue to remain in office; however, their powers to manage the company under external administration are suspended until such time as control is returned.

The statutory moratorium upon entering into voluntary-administration protects the distressed company from various creditor claims and actions. This moratorium extends to charges on the company's assets becoming unenforceable under s 440B *Corporations Act 2001* (Cth), other than charges over perishable assets under s 441C. This is subject to one very significant exception: secured creditors who are substantial chargees over the company's assets under s 441A. The initial Australian moratorium is 25 business days (effectively 5 weeks), albeit with the potential for a 60-day extension by creditor agreement for adjournment under s 439B or by court application under s 439A. The purpose of this moratorium is to enable the insolvency practitioner to investigate the likelihood for a successful restructuring, whilst signalling the urgency inherent in the process as creditors' rights are postponed. Voluntary-administration provides this function to permit the investigation of the company's affairs without the prospect of creditor liquidation, which makes the corporate-rescue process unique, and valuable to

all stakeholders. It facilitates a "circuit breaker" to provide the distressed company with breathing space to evaluate the prospect of rescue and give consideration to rehabilitating the company.

Of primary concern for an administrator upon appointment to a distressed company is the transition of the distressed company moving forward. This usually occurs either by parties defining, and the administrator recommending, a deed of company arrangement or by liquidation. The Australian Part 5.3A corporate-rescue procedure can be seen to incorporate three distinct stages: commencement, investigation and plan formulation and voting on the decision. The administrator, as soon as practicable after commencement, is required under s 438A to form an opinion on whether the best interests of the company's creditors are served by:

i) the company executing a deed of company arrangement;

ii) the administration ending and control reverting back to the directors; or

iii) the company being wound up.

This final stage in the voluntary-administration process represents the decision-making phase, which will ultimately determine the distressed company's fate. The Part 5.3A model relies exclusively on determination by creditors' vote, with the exercise of the administrator's casting vote where required, relying on creditors' ability to use the information reported by the company's administrator to make the correct decision. The aim of these provisions is to facilitate a quick and informal decision-making process

that ignores shareholder interests, with recourse to the Court for adjudication by any aggrieved stakeholders seeking recourse.

The deed of company arrangement provides virtually unlimited scope to facilitate corporate rehabilitation and rescue. If the distressed company is to be rescued following external administration, it is likely this will be achieved by a resolution at the second creditors' meeting in favour of a deed of company arrangement being executed (Fridman, 2003). In accordance with s 444D, upon this resolution being carried, the deed then becomes binding on all the company's creditors, subject to execution occurring within the three-week period specified under s 444C. Significantly, the current Australian provisions provide limited flexibility at the second meeting to facilitate a revised restructure plan. Although under s 439C creditors can consider revisions to the restructure plan, and the possibility exists for adjournment, no specific alternative exists for creditors to vote on a time extension for consideration of a revised rehabilitation plan (Anderson, 2008). Indeed, liquidation under the existing Australian legislation becomes the default alternative for creditors, rather than the development of rescue alternatives to the rejected plan.

Model Characteristics for Corporate Rescue

This section will outline the model characteristics of a corporate-rescue framework to facilitate rehabilitation of viable insolvent or potentially insolvent companies as a matter of course. The ability to devise strategies that embrace all creditor interests and make financial and commercial judgements is the key hallmark of a good rescue regime (Finch, 2005). This concept of corporate rescue seeks to look beyond the concept of

insolvency itself, often advocating a rescue culture as an alternative to liquidation (Hunter, 1999). It achieves the fine equilibrium between those championing the promotion of corporate rescue at the expense of creditors' absolute priority rights and those who see the rights of creditors in insolvency and rehabilitation as paramount (Skeel, 2001). The concept of corporate rescue must therefore seek to achieve a balance between the rules of ut res magis valeat quam pereat ("the transaction shall not perish, but flourish") and pacta sunt servanda ("contracts must be honoured").

The distinguishing feature of the voluntary-administration framework is the facilitation of efficient corporate rehabilitation in scenarios where expected creditor returns from corporate rescue outweigh the returns in the event of winding up (Anderson, 2001). Ideally these returns should also consider the social costs following corporate collapse, which are often difficult to quantify and often significantly underestimated and overlooked. There exists a body of evidence that advocates that corporate rescue and maximisation of outcomes for creditors are best served when distressed companies are not subject to undue delay by directors in seeking external appointment (Milman, 2004). This proposition is supported by the likelihood for directors to exhibit increased business risk-taking when a company is on its last legs, in the hope of saving the company and retaining their offices. This in turn places at risk the going-concern value of the company, and has the potential to prejudice rescue operations, resulting in liquidation and thus further diminishing the value available for creditors (Hahn, 2004). In that regard, the literature also identifies the role for professional accountants, including auditors, to assist in the timely recognition of distress and insolvency, and to

assist with earlier initiation of the voluntary-administration process and the formulation of a restructuring strategy (Routledge & Gadenne, 2000).

This needs to be balanced with the entry criteria required for companies to benefit from this type of rehabilitation regime, with advantages such as the enforcement moratorium representing significant restraints on creditors' pre-negotiated rights. The literature reviewed emphasises the importance of only providing the opportunity to rescue and rehabilitate insolvent companies that have the potential to emerge as efficient and sustainably viable companies (White, 1994). This is due to the risk of higher overall economic and opportunity costs stemming from the failure of an insolvency framework to keep inefficient companies from using such procedures, restructuring and adversely affecting the economy. In that regard, a trade-off exists between the facilitation of entry flexibility to voluntary-administration to encourage use of the procedure and the economic cost of allowing inefficient companies to restructure.

The involvement and participation of creditors in the corporate-insolvency process has widely been regarded as essential in any well-balanced framework, with the level and nature of this participation increasing in corporate-rescue scenarios (Tomasic, 2006). This creditor participation is important not only in ensuring fairness and confidence in the corporate rehabilitation system, but in ensuring that justice "is seen to be done". Indeed, it should be acknowledged that the position of the unsecured creditors of a distressed company is an uncomfortable one, ranking below the status enjoyed by secured and other priority creditors (Milman & Durrant, 1999). Furthermore, the participation of creditors in the rescue process, and in determining the company's fate,

is likely to benefit from the considerable knowledge often held by creditors of the distressed company's viability and operations. Thus, creditor participation should not create undue impediments, delay or undermine proceedings. Rather, efficient and effective creditor participation in corporate-rehabilitation proceedings can be expected to contribute to avoiding the devastating domino-like effects, both economic and social, of corporate collapse (White, 1994).

Additionally, whilst it must be acknowledged that the intent and design of the Part 5.3A framework was to avoid the requirement for court intervention and supervision as a matter of course, the literature suggests that greater flexibility in achieving rescue could be achieved with appropriate industry and judicial cooperation. The provisions under s 447A(1) *Corporations Act 2001* (Cth) state that "the court may make such order as it thinks appropriate about how this Part is to operate in relation to a particular company". Such broad wording of the s 447A provisions in relation to Part 5.3A has provided a mechanism for supervisory powers over administrators, approval and amendments to deeds of company arrangements, powers relating to procedural matters and resolutions of creditors' meetings and the removal of administrators or placement of companies into liquidation. The s 447A provisions provide the Court with wide-ranging general powers that provide scope for the exercise of judicial discretion to alter the substantive operation of provisions under the Part 5.3A legislation (Harris & Gordon, 2005). This flexibility created by s 447A provides the power for courts to mould the statutory prescriptions of how voluntary-administration operates to the characteristics of an insolvent company's particular circumstances (Barrett, 2003). Notwithstanding this potential for such general powers to provide flexibility to the voluntary-administration

process, some have advocated the need for caution regarding the scope of its application. In particular, the increased involvement of courts poses the potential risk of inhibiting the speed of the procedure, increased uncertainty in outcomes, higher costs and the potential misplaced focus on commercial morality (Collins, 2004).

Recent Legislative Reforms

This section will consider the reforms to the corporate-restructuring legislation under the *Corporations Amendment (Insolvency) Act 2007* (Cth), and whether they have been sufficient to facilitate an effective rescue framework in Australia. Notwithstanding recognised limitations within the Part 5.3A procedure, the literature suggests broad underlying support for the voluntary-administration process (Morrison & Anderson, 2006). This in turn has seen a strong preference in governmental policy for evolutionary change as a means to enhance the corporate-insolvency framework in Australia. Indeed, whilst there is little doubt that the "voluntary-administration process has resulted in the saving of many businesses through restructurings…a significant number of administrations (if not the majority) result in liquidation" (Sloan, 2008b, p6). The significant number of companies that ultimately follow this path into liquidation has led many to advocate that the current Australian rescue regime is not sufficiently "rescue-focused". These criticisms surround the inability of the Part 5.3A framework to facilitate the restructuring of companies as a matter of course (Sloan, 2008b). In particular, the corporate collapse and liquidation of Ansett Airlines and HIH in 2001 demonstrated the difficulty of using the Part 5.3A procedure for rehabilitating larger companies (Anderson, 2008). The spotlight on Australia's corporate-rescue framework was the subject of further attention following the economic fall-out after the GFC and high-profile corporate collapses, which included ABC Learning Centres, Allco Finance

Group, Australian Discount Retail, Commander Communications and Babcock & Brown. It also formed the basis for renewed calls for a debtor-in-possession model of corporate rescue similar to Chapter 11 in the US, to improve the probability of successful corporate rescue for larger Australian companies.

The 2007 reforms consisted of a number of amendments to the current provisions contained in the *Corporations Amendment (Insolvency) Act 2007* (Cth) which were adopted with a view to increasing the flexibility to rehabilitate insolvent companies (Table 1). These reforms have made headway in addressing some of the concerns and criticisms of the previous legislation.

Table 1: Summary of Reforms Relating to the Part 5.3A *Corporations Act 2001*

Reform	**Description**
Share Dealings by Administrator (Item 29 Schedule 1)	This reform includes watering down the previous prohibitions relating to an administrator's ability to deal with a company's shares without court approval. It includes the provision of powers to an administrator to sell shares of the company with the consent of shareholders. This reform can be seen to facilitate the potential for restructuring the balance sheet through the use of equity rather than relying purely on "cramming down" debt, thereby providing the opportunity to strike a sensible balance between the rights of members and creditors respectively.
Debt-to-Equity Swap Exemption	This reform provides exemptions from the fundraising regime for deeds of company arrangements that include a debt-to-equity swap, similar to those applicable to schemes of company arrangements. This provides significant benefits to encourage creditors to participate in and share in the benefits of the future of a company through the swap, with minimal time and cost, including removing the need for a prospectus.
Changing of Company Name (Item 49 Schedule 1)	This reform includes addressing difficulties encountered by an administrator to alter a company's name, by removing the need to obtain shareholder consent through a special resolution of the members. This will assist in addressing the significant devaluation of the company's name and brand that often transpires as a result of

	insolvency.
Exemptions to notify DOCA (Item 50, Schedule 4)	Administrators' now have the ability to apply to the court for exemption from the requirement to notify that the company is subject to a deed of company arrangement (DOCA), providing significant benefits for companies seeking to avoid the detrimental impact and continued stain of failure on the company's trading, whilst subject to a deed.

Subsequent to the 2007 legislative changes outlined above, the Australian Federal Government released a discussion paper titled *Insolvent Trading: A Safe Harbour For Reorganisation Attempts Outside of External Administration* (Safe Harbour, 2010). This discussion paper focused on attempts by insolvent Australian companies to informally rehabilitate outside of external administration in the context of the existing insolvent trading laws. It examined a number of potential options for legislative change to facilitate improved outcomes and business rescue, including:

i) a modified business-judgement rule relating to a director's duty to avoid trading whilst insolvent; and

ii) a moratorium being invoked from insolvent trading whilst the company attempts to rehabilitate.

The Federal Government acknowledged that "placing a company into voluntary-administration may not always represent the most appropriate method to effect a corporate rescue [and that] informal work-outs play an important role in preserving a troubled business" and protecting stakeholders (Safe Harbour, 2010). In particular, the discussion paper sought to examine barriers created by the existing insolvent trading legislation during insolvent companies' bona fide attempts to restructure. This included

the impact of illiquidity or restrictions on the availability of credit, which had the potential to trigger temporary insolvency for distressed companies, such as that experienced during the GFC. Whilst the discussion paper resulted in the Treasury receiving 22 submissions, the changes considered under the discussion paper were not pursued under the Government's corporate-insolvency reform. Instead, the recently introduced *Insolvency Law Reform Bill 2013* focuses on a narrow framework of changes surrounding the regulation of the industry, common rule alignment between corporate and personal insolvency and the registration, regulation, discipline and deregistration of practitioners. In that regard, these reforms hold limited relevance to the scope for corporate rehabilitation, and thus the subject of this research. The 2010 Safe Harbour discussion paper will, however, inform the interpretation of subsequent findings later in this thesis.

Barriers to Restructuring

Notwithstanding the above government and legislative measures concerning reform to the insolvency framework and industry, the review of literature indicates a substantial body of information that continues to identify a number of fundamental barriers to successful restructuring in Australia, including the secured creditor exemption, the insolvent-trading regime, *ipso facto* clauses, procedural accountability & abuse, employee creditors and entitlements and globalisation & cross-border insolvency convergence. The review of the literature has also revealed research gaps regarding detailed "rescue" statistics under the Australian insolvency framework. Despite a number of reports from government bodies, committee papers and calls for review submissions, there remains a lack of detailed data and empirically based information on the procedure, which has constrained policy debate. Indeed, there is some suggestion

that as few as one in 15 Australian companies successfully manages to resume trading following voluntary-administration (Restructuring Workings, 2009). Furthermore, from a cultural perspective the concept of insolvency and corporate rescue in Australia potentially carries the stigma of corporate failure. This stigma is particularly challenging to address due to the difficulty in altering such entrenched values through public policy (Hofstede, 2007). This is particularly important in an environment where the reputation of a company has become increasingly important as a factor influencing consumer decisions and investor behaviour (Hale, 1999). This stigma of failure can be contrasted with the corporate and financial environment in other jurisdictions such as the US, where "if you go into Chapter 11, you put it on your curriculum vitae" (Crutchfield, 2003, p124).

Secured Creditors

This section will consider the exemption of secured creditors holding a charge over the whole, or substantially the whole, of the company's property under the Part 5.3A legislation, and the potential resultant barrier to the effectiveness of the regime. This limitation arises in that secured creditors are only bound under a deed of company arrangement to the extent to which they agree or, in limited circumstances, the court is able to order under s 444D(2). Whilst the rights of limited secured creditors can be restricted by the Court under s 444F, the Court has no power to restrain a secured creditor that holds a charge over the whole or substantially whole of the company. The result is that distressed companies using the voluntary-administration procedure have "no protection from banks then putting the company into receivership….saying 'right we're going to get our money out of it'" (Turnbull & Franklin, 2008). The potential for

this type of opportunistic behaviour is identified as a serious threat to the restructuring process, with consequent, and unnecessary, value destruction.

The UK legislation seeks a mid-point whereby the restructuring legislation prohibits floating-charge holders from using administrative receivership, instead requiring general enforcement by secured creditors through the administration process. This seeks to provide some redress from the prior position, whereby receivers tended to focus on the speedy resolution of the secured-charge holders' interest, often without any sustained consideration or obligation to the remaining body of creditors. The challenge in legislating to constrain secured creditors' rights is the converse reality that insolvency practitioners often depend on banks for repeat insolvency work, particularly resulting from bank powers surrounding appointment of choice (Davies, 2002). This in turn leads to administrators developing and pursuing ongoing relationships with banks. Furthermore, administrators often rely on banks for funding throughout the rescue process, which results in the banks having a vested interest in ensuring that any restructure proposal occurs under acceptable terms, providing considerable power to influence strategy (Day & Taylor, 2001). In that regard, it must be acknowledged that "there is no legislation that can address the economic facts of life: he who pays the piper will call the tune" (Swain, 2003).

The absence of "super-priority" ranking for funding advanced to assist in the rehabilitation process has also been identified as a constraining factor in banks' willingness to facilitate the rescue of distressed companies. Instead, without super-priority, banks advancing additional rescue funds are likely to behave in a manner

highly motivated and focused on negotiating strategies that protect their existing exposure and interests (Finch, 2005). Herein lies the considerable difficulty in raising post-appointment finance for a distressed company to facilitate restructure. In fact, this has provided the basis for the British Bankers Association's claims that "receivership operated as an effective way of saving businesses because receivers, acting for the banks, could operate very dynamically" (British Bankers Association, 2001), benefiting from single-party decision-making. In addition to banks' pivotal role of providing ongoing funding during the rescue process, they are also likely to possess valuable and detailed operational and financial information about the distressed company. However, the inclination for banks to work with insolvency practitioners to share this information cannot be accepted as a given. Whilst contractual negotiation of commercial interests often presents an effective option from the perspective of secured creditors, the need for external administration of distressed companies is significantly more important to creditors without security to rely upon (Anderson, 2001).

The current direction of UK reforms has sought to elevate the corporate-rescue goal by shifting privilege and protection away from secured creditors' rights by prohibiting the use of receivership by floating-charge holders. The premise of this paradigm shift is the prevention of instances where secured creditors used the appointment of receivers to act precipitously, thereby diminishing the likelihood of corporate rehabilitation (Fridman, 2003). The Australian voluntary-administration framework constitutes a trade-off in favour of the challenges associated with having to concentrate the minds and objectives of diverse creditor classes to facilitate corporate rehabilitation, whilst pursuing greater creditor fairness. A rehabilitation regime for distressed companies with a moratorium

that includes all creditors would restrict the power of secured creditors to instigate the receivership procedure, thereby assisting the objective of rehabilitation and a broader creditor-focused approach (Merrett, 2003).

Insolvent Trading

Section 588G of the *Corporations Act 2001* (Cth) outlines a duty on company directors to prevent insolvent trading. The insolvent-trading provisions under the existing legislation have been the source of a number of criticisms and policy arguments surrounding the Australian rehabilitation system (James, Ramsay & Siva, 2004). Implemented under the recommendations of the Harmer Report (1988), the provisions seek to deter "hold-out" behaviour by directors of a distressed company approaching insolvency, through the belief that there is nothing to be lost in continuing if there is potential upside just around the corner. This has been argued to compound the financial negative impact on unsecured creditors as a result of external administration. In turn, these insolvent-trading provisions have been subject to criticism for having the effect of encouraging directors to become unduly adverse to risk (James, Ramsay & Siva, 2004), resulting in directors prematurely placing companies into voluntary-administration to avoid the threat of personal liability. There exists, however, a fundamental flaw in the argument that insolvent trading prevents the effective rescue of companies that could potentially trade out of financial distress under existing circumstances or informal restructure. There are tangible reasons why the risks of corporate failure in the lead-up to insolvency should not be borne by creditors. A key reason is the incentive for directors to engage in excessive risk-taking "to put it all on the line" in their pursuit of evading insolvency. In that regard, the mechanism of personal directors' liability is to

ensure that the interests of the creditors intrude (*Kinsela v Russell Kinsela Pty Ltd* [1986]), effectively preventing further gambling using creditor's funds.

The contemporary issues surrounding the impact of insolvent trading liability under the Australian legislation have resulted in the "impetus for most administrations being the avoidance of personal liability for insolvent trading" (Sloan, 2008b, p10). Whilst such strict liability undoubtedly has merit for the protection of creditors, the literature includes arguments that it also creates an incentive to place the company into liquidation and "start again" (Robinson, 2009). This provides a platform for consideration to advocate corporate rehabilitation through external administration mechanisms to "introduce American-style bankruptcy laws that allow companies to continue trading whilst insolvent…known as Chapter 11" (Cameron, 2008). The potential merits of this "debtor-in-possession" model is discussed later in this chapter.

A further issue surrounding the insolvent trading legislation is the reluctance it creates for third-party involvement in the rescue of a company, due to the potential for shadow director liability being imposed through the process of informal rehabilitation (Routledge & McNamara, 2005). The s 588G provisions relating to insolvent trading contain a broad definition of a company director, expanding the duty to include shadow directors and de facto directors. The concept of a shadow director incorporates a person who is not appointed by the board, but whose wishes or instructions are followed by the directors of a company, and under whose direction the latter are accustomed to act (*Standard Chartered Bank of Australia Ltd v Antico,* Nos 1 and 2 [1995]). De facto directors, on the other hand, are persons acting as a company director without being

validly appointed to the position. This broad definition of "director" under the legislation has been argued to represent a significant deterrent to qualified experts becoming directors of distressed companies (James, Ramsay & Siva, 2004) at a time when their expertise is most critical. Overseas, two key trends identified in achieving the resurrection of insolvent companies are the "innovations of the placement of chief restructuring officers into a company in financial difficulty and the employment of a 'loan to own' strategy" (Sloan, 2008b, p10). The feasibility of such reconstruction tools in Australia is limited by the shadow-director provisions of the insolvent trading legislation, which discourage such appointments to companies in failing corporate health. This strict shadow-director framework has also been argued to inhibit the proactive involvement by bankers in the redirection of the company for fear that shadow-director liability may be imposed on them (Brown, 2009). The question thus arises as to whether narrowing the s 588M definition of a director and softening the scope of such shadow-director liabilities would mitigate the reluctance of such experts to facilitate the restructuring process.

Ipso Facto Clauses

An *ipso facto* clause is a contractual clause stipulating the consequences of the insolvency of a party to the agreement. The significance of *ipso facto* clauses as a common provision in most contracts in Australia derives from the corresponding right of the counterparty to terminate a contract in the event that a company becomes insolvent. This has the potential to significantly inhibit a company seeking to restructure, as the appointment of an administrator will almost always provide such grounds for termination. The absence of a measure under current Australian restructuring legislation preventing "a supplier or a customer of the company from

cancelling contracts of supply on the basis solely of insolvency (as opposed to non-performance or repudiation)" (*Onefone Australia Pty Ltd v One Tel Ltd* [2007]) often corresponds to a crippling and immediate cessation of a company's operations and any possibility of restructure. The absence of protection under Australian legislation of the enforcement of this type of *ipso facto* clause, such as a moratorium on enforcement, will often strike at any company's ongoing ability to trade, and destroy its major asset: its customer base.

Indeed, *ipso facto* clauses have been advocated as one of the key criticisms of the Australian framework, with the ensuing catastrophic results from the voiding of contracts causing irreparable damage to business (Parbery, 2008). The standard presence in contracts of *ipso facto* clauses that trigger upon entering into voluntary-administration often bring down the business upon appointment and kill any restructuring prospect (Eyers, 2009). This effectively changes the Part 5.3A provisions designed to help companies keep afloat from a life jacket to an anchor by depriving the business of essential contracts. Chapter 5 of this thesis will discuss the potential for the adoption of restructuring provisions such as in the United States (Bankruptcy Code s 365(e), *United States Bankruptcy Reform Act 1978*), where reliance on *ipso facto* clauses for the termination of contracts on the ground of insolvency alone is prohibited.

The Administrator and Procedural Accountability

Once appointed, the company's administrator takes sole custody of the power to deal with the company's assets under s 437D, acting as the agent of the company in respect to the exercise of all powers and functions as administrator. However, the use of these

powers is tempered in the restructuring process under Part 5.3A, and the administrators also become liable under s 443A for any debts incurred in the ongoing trading of the business and performance or exercise of their powers. In practice, the extent of any such exposure is usually mitigated by the entitlement under s 443D for the administrator to be indemnified from realisations of the company's assets. Notwithstanding, this trading-risk exposure can be seen to weigh heavily on administrators' shoulders as they seek to facilitate a restructure and relegate the corporate-rescue priority during the voluntary-administration process (Agardy, 2002).

All participants in the insolvency rescue process - the insolvency practitioner, directors and bankers - are affected by differing incentives and motivations surrounding the rehabilitation process, and often see the world from differing perspectives. These multi-party interests may range from banks focusing on the priority protection of secured corporate asset values, directors protecting employment and insolvency practitioners on complying with their statutory mandates and protecting creditor interests. Ultimately, the voluntary-administration corporate-rescue regime, such as in the Australian and the UK legislation, creates a complex hierarchy as it sets out an administrator's objectives in serving a broad spectrum of creditor interests (Frisby, 2004). Furthermore, these objectives should be recognised in the context of the challenges associated with commercial decision-making, in that "actions which at the time of taking were known to be risky but justifiable in terms of expected benefits, can seem unjustifiable with hindsight when a 'bad' outcome has materialized" (Armour & Frisby, 2001). This in turn is likely to translate into insolvency practitioners behaving in a highly risk-averse manner, thus potentially obstructing the likelihood of corporate rescue as the outcome.

This potential for undue conservatism in the quality and consistency of administrators' recommendations to creditors in their assessment of a company's restructuring and realisation prospects was identified as an impediment to the operational effectiveness of the Part 5.3A legislation. This was regarded as particularly important, given the extent to which creditors rely on such recommendations in making their decision about the fate of the insolvent company (Routledge & Gadenne, 2000).

The importance of procedural accountability and administrator independence and objectivity is particularly highlighted in the Australian context, with pre-packaged restructure arrangements. In the Australian market, the use of so-called "pre-packs" to achieve a planned corporate restructure has had limited application in practice, despite the existing infrastructure under the legislation to achieve this outcome (Lloyd, O'Brien & Robertson, 2009). Whilst pre-packs have taken various forms across different insolvency jurisdictions, of most significance for Australian comparative purposes has been the widely popular UK version. Using the UK voluntary-administration framework, this form of pre-pack reflects the negotiation for the sale of all or part of the insolvent company's business or assets prior to the formal appointment, with the subsequent sale occurring shortly after appointment. Often such an arrangement is undertaken among the related parties to the insolvent company, with the transaction occurring without marketing the business to other potential purchasers and without the need for creditor or court approval (Walton & Wellard, 2012). The challenge of this UK model in an Australian context has been the clear actual or perceived threat to objectivity where an administrator has been involved in the planning of a pre-pack, potentially providing a direct conflict to their duty to the company's creditors. This lack

of creditor transparency prior to the execution of a pre-pack business sale also risks the perception of an administrator's independence being compromised or tainted, and brings into question their ability to impartially investigate an insolvent company's affairs.

In particular, where such pre-pack sale occurs in conjunction with parties related to the insolvent company, such criticisms surrounding independence, objectivity and conflict concerns are likely to become heightened and result in greater creditor disenchantment (Walton & Wellard, 2012). This issue of practitioner independence and such requirements in the Australian context are outlined both in professional codes of conduct such as those of the IPAA and in general law, and have evolved to be considered almost absolute. Whilst codes of conduct do not have the force of law, they are extensive in application and play an important role in insolvency practice, with Australian courts recognising their importance in assessing actual and perceived independence (Walton & Wellard, 2012). This presents a significant barrier not only to the potential for administrator involvement in the negotiation, engineering and preparation of a pre-appointment sale of business, but also is more broadly restrictive of the scope of pre-appointment planning undertaken by administrators.

Whilst the literature recognises a *prima facie* acknowledgement of the potential merits of pre-packs in an Australian context, there is a distinct preference for achieving such outcomes through court sanction or within the paradoxical confines of a creditor-approved deed of company arrangement or similar process (Walton & Wellard, 2012). Whilst it is acknowledged that administrators in Australia have the power to exercise

their commercial judgement in sanctioning an early sale of assets without testing the market, there exists a clear *prima facie* aversion to such course of action in the absence of a compelling justification or court approval. In that regard, in the Australian context the acceptance of these types of pre-pack arrangements have been limited to scenarios where a trading administration is clearly likely to destroy goodwill or business value, and the pre-pack is the only feasible option (*DKLL Solicitors v HMRC [2008]* 1 BCLC 112). From a framework-development perspective, this has seen the key focus of Australian pre-pack discussion on increased planning and identification of restructuring outcomes prior to formal insolvency, rather than the timing of its implementation (Poulos & McCunn, 2011). In other words, the pre-appointment plan is prepared with the goal of potentially preserving asset values and achieving certainty by reducing the timeframe to achieve the desired outcome. The pre-pack concept discussion in Australia has sought to distance itself from the UK model of diminished creditor participation and abrogation of rights, and has attached itself to the concept of earlier intervention and planning to achieve improved restructuring outcomes. Whilst there is recognition that the timing of pre-pack implementation has an inverse relationship to the level of value destruction likely to occur, is has been acknowledged that the UK model of immediacy of sale post-appointment runs contrary to Australia's entrenched culture of creditor determination (Poulos & McCunn, 2011).

Employee Creditors & Entitlements

With Australia's employee-entitlement regime being amongst the most comprehensive in the world, it is no surprise that a key challenge to any restructure relates to addressing employee creditors. A company "pregnant with employee entitlement obligations is a very unfavourable take-over target in a restructuring" (Sloan, 2008b, p8), as the heavy

burden assumed by an acquirer of the outstanding employee entitlements, unlike that of general creditors, remains subject to s 556 priorities. This inability to "cram down" employee entitlements under a deed flowing from the mandatory priority of these entitlements inhibits the likelihood of restructuring, often wiping out and exceeding any residual enterprise value in the business. In the continuing absence of an employee-entitlement limit, despite one of the most generous entitlement regimes in the world (Whelan & Zwier, 2005), the ongoing threat to distressed companies remains that such entitlements will diminish the very jobs by which they have accrued.

A further important issue that arises under the current restructuring regime is that the safety net for employee entitlements provided under the General Employee Entitlements and Redundancy Scheme (GEERS) is normally only applicable to companies placed into liquidation, thereby excluding companies that are subject to a deed of company arrangement. Thus, when confronted by a choice between the potential for the restructure of a company under a deed or placing the company into liquidation, there is an inherent and perhaps inadvertent incentive for employees to pursue the latter course where employee entitlements are threatened (Whelan & Zwier, 2005). With employee creditors often controlling the majority vote by number in an administration, the resultant creditor voting pool can produce results that ironically protect entitlements at the resultant cost of ongoing employment. Whilst there is no doubt that the importance and rights of employees, including their entitlements, is fundamental and should be protected, this research will seek to understand the implications of restructuring where such challenges are present. The context is thus that of preserving not just entitlement payments, but also business viability, and thereby ongoing employment.

Globalisation and Cross-border Insolvency Convergence

In the context of the current dynamic economic environment, there has also been an increasing focus on globalisation and increased uniformity in international standards for insolvency legislation. In that regard, the spotlight has turned to comparing the current Part 5.3A legislation to its international counterparts to identify and consolidate cross-border uniformity and a best-practice framework. This increasing focus on global and regional insolvency legislation and international best-practice norms is seen as fundamental in providing a foundation for the globalised market economy. Whilst in the Asia-Pacific geographic region, extensive efforts have been made in recent years to incorporate and develop insolvency legislative frameworks towards international standards, the legal protection of creditors in Asian jurisdictions remains relatively weak (Tomasic & Little, 1997). The development of these broader international principles and guidelines of insolvency law have largely been derived from the insights and experiences gained from countries with established insolvency frameworks and recent reform efforts. These guidelines have sought to outline flexible, internationally recognised insolvency benchmarks and standards to provide a broad-spectrum assessment tool that can help countries evaluate the effectiveness of insolvency systems and creditors' rights (World Bank, 2010).

Prior to the regional Asian economic crisis in the late 1990s, insolvency legislation in the region was often "out of date and irrelevant to modern commercial needs" (Harmer, 2000). However the actual practice of implementing international best practice and its compatibility with local countries' existing insolvency framework, especially in relation to the less-developed countries, has remained a challenge. This has reflected a need for

sensitivity to the reality of existing weaknesses in legal systems, financial institutions, mechanisms for social protection and corporate governance, coupled with resource and capacity constraints and local corrupt practices (Tomasic, 2006). This can be seen to have largely been responsible for a significant "implementation gap", particularly in eastern Asia, whereby the existing legal systems have provided a major impediment to the adoption of international insolvency standards. In particular, effective creditor participation has remained elusive, with local traditions and culture often affecting the nature and extent of creditor participation in the corporate-rehabilitation process. Indeed, much of the restructuring that has taken place in Asia has represented fictional rescheduling of debt without any operational restructure, using negotiations to extract additional equity, security, fees or security without any commitment to long-term rescue, and without any realistic expectation of companies' survival (Vassiliou, 2006). This widening bridge between insolvency standards across the Asia-Pacific region remains an ongoing issue of concern in the adoption of standardised insolvency practices, and it has become increasingly clear that such reforms will not be fully embraced until countries recognise that such a framework is fundamental to sustainable economic development. Given the generalised and widespread lack of institutional capacity, together with cultural appetite for informal corporate rescue - particularly in developing parts of Asia - corporate distress will likely continue to be resolved informally as the region transitions to a convergent insolvency framework.

Furthermore, an impediment to the adoption and acceptance of international and cross-border insolvency standards can also be seen to occur where a country such as Australia has a well-developed and strong framework of insolvency legislation (Tomasic, 2006).

It is only natural that any move towards globalised-insolvency law reform and convergence towards common insolvency legislation should draw from jurisdictions that have a history demonstrating how proposed legislation may function. However, it should be also recognised that it is one thing to advocate for common cross-border insolvency legislation, and quite another to have that legislation function in the same manner across different cultural and social conditions, legal frameworks and commercial environments (Anderson, 2008).

Corporate Restructuring Models in Other Jurisdictions

This section will consider the operation of other international best-practice rescue frameworks, with a view to locating and overcoming the barriers to effective restructuring in Australia. Whilst New Zealand has recently implemented a voluntary targeted corporate-rehabilitation scheme similar to the Part 5.3A legislation, an analysis of the UK and US legislation is also valuable in examining the Australian framework.

Enterprise Act 2002 - UK Insolvency Regime

On a best-practice basis the comparative understanding of the UK *Enterprise Act 2002* is worthwhile. The UK legislation represented a fundamental reform that has sought to establish a robust rescue regime in the UK. This was seen as essential in providing distressed companies with a reasonable chance for rehabilitation (Finch, 2002). The framework of the UK regime is grounded on the furtherance of rescue by providing the mechanisms to implement sound rehabilitation strategies and judgements, which facilitate timely decision-making and coordinated action (Frisby, 2004). Similar to the

Australian voluntary-administration legislation, the UK model places control of the distressed company in the hands of an independent insolvency practitioner, in the form of an administrator. This advocates the proposition that in times of corporate distress, "English insolvency law has traditionally been built on the assumption that where a company becomes insolvent this is usually due to a failure of management…who are responsible for the company's plight in the first place" (Finch, 2002, p124). This is diametrically opposed to the model implicit under the US regime, which seeks to treat corporate distress as an issue requiring attention rather than blame, often under the continued judgement and skill of the existing management (Moss, 1998). The argument in favour of the UK model is that insolvency practitioners have the ability to determine the extent of the role played by directors based on their independent assessment and judgement powers. This in turn provides a "best of both worlds" approach to corporate rescue, with the administrator bringing together divergent interests that would otherwise provide a tendency to undermine cooperation, driven by differing motives and the absence of an alignment of interests.

Most notably, however, the UK regime differentiates from the Australian model by focusing on the importance of judicial oversight to support coordinated action and facilitate rescue outcomes (Finch, 2005), revitalising judicial involvement in the administration process. In that regard, not only does the responsibility for the protection of stakeholders' substantive and procedural rights lie with judges, but their review powers also serve as a mechanism for coordination between vested parties to enhance the likelihood of rescue. In practice however, judges are unlikely to intervene when it involves second-guessing the commercial judgements of administrators (Swain, 2003).

It is more likely that judicial contribution will take the form of shielding administrators from unnecessary delays in pursuing their statutory objectives, with a view to expeditiously achieving restructure. During administration, the UK model operates in a rescue-optimising manner by imposing a moratorium on the enforcement of charge-holder security and any commencement of other insolvency proceedings. These amendments seek to remove the predisposition to solely focus on realising returns for floating-charge holders under administrative receivership, and to benefit the interests of all creditors. Significantly, the UK legislation also "ring-fences" a proportion of net floating-charge realisations from the company, which are required to be made available to unsecured creditors (Finch, 2005). Floating-charge holders are subsequently only able to benefit from the distribution of funds surplus to the above becoming available for distribution.

Chapter 11 – US Bankruptcy Regime

The focus of this section is a comparative analysis of the Chapter 11 Bankruptcy regime and the mechanisms that make the framework "widely considered to be one of the most debtor-friendly reorganization laws in the industrialised world" (Lewis, 2001). The primary distinction between the US regime and the Australian voluntary-administration model is that the former embraces a debtor-in-possession (DIP) regime, rather than the administrator- or practitioner-in-possession (PIP) model adopted in Australia. The DIP model largely leaves the management in the control of the company (Westbrook, 2004), advocating that the existing directors are likely to bring to the table greater firm-specific operational and staffing knowledge in facilitating a restructure. This is contrasted to the PIP regime, where rehabilitation expertise, strategies and funding are likely to be provided by the insolvency practitioner and banks, overriding the need to place a great

deal of reliance on the input of directors. However, one factor that appears to have been overplayed in the DIP-versus-PIP debate in assessing the more effective mechanism for rescue is the degree to which under either scenario the existing management or the independent practitioner is really in charge (Franken, 2004). In fact, whilst both models contain a single formal authority to lead policies or decision-making, the dominance of that authority is tempered by discussion, negotiation and consultation arrangements between various parties in final decision-making.

Table 2 shows the top 10 bankruptcy filings under US Chapter 11, and demonstrates in a majority of these appointments, the company was able to successfully restructure.

Table 2: Ten Largest Bankruptcy Filings Under Chapter 11

Company	**Date**	**Assets US$M**	**Outcome**
Lehman Brothers	2008	$691,063	Liquidation
Washington Mutual	2008	$327,913	Liquidation
WorldCom	2002	$103,914	**Restructure**
General Motors	2009	$91,047	**Restructure**
CIT Group	2009	$80,448	**Restructure**
Enron Corp	2001	$65,503	Liquidation
Conseco	2002	$61,392	**Restructure**
Chrysler Corp	2009	$39,300	**Restructure**
Thornburg Mortgage	2009	$36,521	Liquidation
Pacific Gas & Electric	2001	$36,152	**Restructure**

The available literature supports the proposition that whilst a majority of Chapter 11 cases do fail, when the question becomes whether most large companies under Chapter 11 fail, the answer is no (Broude, 2003).

Furthermore, the Chapter 11 regime is attractive to directors as a rehabilitation process because it offers a moratorium on claims, whilst allowing existing management of the distressed company to retain control (Fridman, 2003). This retained stake in the distressed company's future provides a strong motivation for focusing attention on, and investing effort in, ensuring the success of the restructuring process. Herein lies the challenge posed by the DIP system: does liquidation or rehabilitation offer the most appropriate path for the distressed company, taking into consideration the potential managerial incentive to opt for rescue and thus remain in office? This presents a scenario whereby companies that should be placed into liquidation potentially file for reorganisation, which conflicts with maximizing the return and protecting the interests of creditors (Bogart, 1998). In this regard, the PIP model, which assumes an administrator with very broad control powers, presents a lower bias risk relating to the decision to liquidate with the removal of control from directors. This bias is partially mitigated, however, by the close oversight of the US Bankruptcy Court under Chapter 11 proceedings, in contrast to the limited supervisory role played by the Australian courts under voluntary-administration (Corporations and Markets Advisory Committee, 2003).

Indeed, whilst companies under Chapter 11 restructuring benefit from the automatic stay on secured parties from enforcing their security, and from the prohibition against

relying on insolvency as grounds for contract termination by parties to an agreement[1], there are also significant shortcomings with the Chapter 11 procedure. These include an approach to corporate rehabilitation that is expensive, takes too long and is administratively cumbersome (Broude, 2003). In fact, whilst estimates of the average time a distressed company spends in Chapter 11 vary significantly, no average suggests a timeframe shorter than 10 months (Lewis, 2001). Any benefits that accrue with the DIP model under existing management and without the constraints of an administrator are also eroded by management spending this extended period potentially distracted by the Chapter 11 case. A further distinction relates to the extent of creditor rights under the respective procedures, with creditors and, in particular, unsecured creditors under voluntary-administration afforded rights that effectively allow them to shape the future of the distressed company. Under the Chapter 11 regime, there exist far stricter controls around creditor participation, including the prevalence of 'cram-down', where a rehabilitation plan becomes binding upon dissenting creditors (Lewis, 2001). This approach can be contrasted with the traditional insolvency claims hierarchy, whereby creditors effectively supplant shareholders as primary beneficiaries of the preservation and realisation of going-concern value (Baird & Jackson, 1988). This is due to the equity of an insolvent company becoming largely worthless. In that regard, the literature suggests the US Chapter 11 model, whilst possessing attributes that should be considered for adoption into the Australian framework, provides a limited framework for restructuring beyond those very large US companies, and fails to consistently achieve the primary objective of a rescue culture; that is, "distinguishing those firms

[1] United States Bankruptcy Reform Act 1978, Bankruptcy Code ss365(E)

with long term potential viability from those firms without such prospects, and assuring continuance of the former and liquidation of the latter" (Lewis, 2001).

CONCLUSION

The literature reviewed thus far relating to corporate rehabilitation and the voluntary-administration legislation in Australia provides, in the opinion of the author, strong foundations for the current research and ongoing commentary in the area. The purpose of the current research is to examine and study practitioners' perspectives of the Australian Part 5.3A legislation in practice, with a view to identifying themes and trends relating to the existing rehabilitation regime. The author hopes that this study will provide potential explanations for the trends identified and increase the body of understanding surrounding the operation and effectiveness of the present legislation. It is hoped that this research will contribute to the body of knowledge through understanding the practical experience of restructuring insolvent Australian companies and avoiding the spectre of corporate failure.

The importance of developing a corporate culture where social values and ongoing employment are maintained through averting corporate collapse, is as significant in assessing the value of corporate rescue as the economic and financial value such rescue brings. This is in contrast to the present status quo in Australia, where, according to the literature reviewed, primacy of legislation focuses on the maximisation of return to creditors rather than the rescue of distressed companies per se. This is anticipated to include the role and implications relating to secured creditors in Australia, and, in particular, banks and their potential reluctance to compromise and restructure loans to prevent distressed companies from becoming insolvent. From the author's experience

and observations, banks may be reluctant to compromise loans due to the potential to set a market precedent that encourages other distressed companies to seek debt relief, which would in turn potentially affect loan recovery. This is further compounded by the priority ranking from which secured lenders benefit, providing little incentive for banks to prioritise a company's rescue; thus the brunt of value destruction is borne by unsecured creditors. This presents conflicting risks: the potential for premature liquidations where secured creditors are permitted to enforce their security when a company enters formal administration, versus the likelihood of increased costs and reduced availability of financing where secured creditors' rights are constrained (Broadie, Chernov & Sundaresan, 2007).

The research will also seek to examine the appropriateness of a move towards a more "debtor friendly" approach to restructuring. This concept relates to legislation such as the US Chapter 11 being characterised by the debtor remaining in possession (in the absence of specific "fraud, dishonesty, incompetence or gross mismanagement" under Bankruptcy Code ss 1104(a)(1) (*United States Bankruptcy Reform Act 1978*), with no financial-solvency standard required. The DIP approach has largely been attributed to a desire to avoid the displacement of management by an administrator who may have little understanding of the business and its operations. This potential benefit in turn needs to be weighed up to ensure that "management doesn't spend more time managing the Chapter 11 case than it does managing the business" (Broude, 2003, p4). Viewpoints range between both ends of the creditor debtor spectrum. Those advocating the merits of the "creditor friendly" regime pursued in the Australian framework include detractors of the "pro-debtor-anti-creditor juggernaut known as Chapter 11. The debtor

in possession? Good grief! Why let the miscreants who brought about the financial failure continue to captain the sinking or sunk ship?" (Broude, 2003, p4). On the other hand, advocates of the debtor friendly system have responded with opposing criticisms: "That's right, sell only enough to pay the secured creditor and damn the unsecured creditors, employees, or anyone else with the temerity to claim an interest in the distressed business" (Broude, 2003, p4).

Whilst it has been advocated that Part 5.3A is the "best system for Australian conditions while perhaps not providing a perfect solution for all companies…subject to a dramatic downturn in economic activity" (Anderson & Morrison, 2007, p.257), the economic volatility from 2007 to the present provides this very catalyst. In the current distressed economic climate, an opportunity exists to undertake research and formulate law-reform proposals in the corporate-rehabilitation area, which until recently had largely been academic in practice, given the sustained period of strong economic growth (Eyers, 2009). The researcher recognises, however, that legislators need to be careful that we do not advocate short-lived legislative amendments, specifically framed to respond to individual financial crises, which cause more damage or inequity when the crises subside. Consequently, a key focus of this research will be to ensure that impediments identified to achieving successful corporate restructurings are examined in sufficient depth.

CHAPTER 3: METHODOLOGY

INTRODUCTION

This chapter outlines the selection and justification of the methodology used in this study to explore the perspectives and experiences of insolvency practitioners working within the Australian insolvency field. This research is grounded on the perspectives and experiences of insolvency practitioners, suggesting a qualitative approach to research design. The objective of using insolvency practitioners as participants was to gain insight into the perceived operating effectiveness of the legislative framework in practice. This participant group is significant insofar as they have expertise in and responsibility for administering the voluntary-administration legislation, are suitably qualified and are entrusted with the independent assessment and judgement powers relating to the procedure. Insolvency practitioners are also independent of key stakeholders, including the company, directors, creditors, employees and customers, and in that regard provide relative objectivity to the voluntary-administration process. Insolvency practitioners are most familiar with the use of the legislation to restructure companies in practice, including its operation and effectiveness. This will provide an important insight into practitioners' perspectives on how the advancement of a corporate "rescue-based" culture could be facilitated in Australia, and provide feedback on the relevant issues insolvency practitioners are experiencing, including any practical barriers that inhibit best practice in the restructuring of viable companies.

Following a brief description of the theoretical considerations that have informed the present research, the design of the project will be described in detail. This chapter will then go on to describe the methods undertaken in addressing the research questions.

THEORETICAL CONSIDERATIONS

The epistemological and ontological assumptions that influence the present research are constructionist in nature, and identify the theoretical perspective as interpretivist. This is grounded on the assumption that practitioners' perspectives are informed by their experiences, which are in turn informed by the legislative framework, which itself is socially constructed (Turkel, 1988). Ontologically, this research assumes that reality is constructed by individual practitioners, the discipline of insolvency, the law and society itself; thus the position adopted is constructionist. This linkage between the constructionist epistemology and interpretivist theoretical perspective reflects an underlying assumption that knowledge and interpretation are not distinct (Crotty, 1998).

Traditionally, it has been asserted that "mainstream accounting is grounded in a common set of philosophical assumptions about knowledge, the empirical world, and the relationship between theory and practice" (Chua, 1986, p.601). However, adopting an interpretive approach introduces an alternative perspective that is potentially rich in research insights. Indeed, the accounting discipline and research have historically been criticised as being hampered by some theories about practice that bear little relation to actual accounting practice (Kaplan, 1984). Traditional accounting assumptions have, in this respect, limited the scope of accounting research undertaken and the application of research methods, and thereby impaired fundamentally different potential insights which would enrich the understanding of accounting in practice.

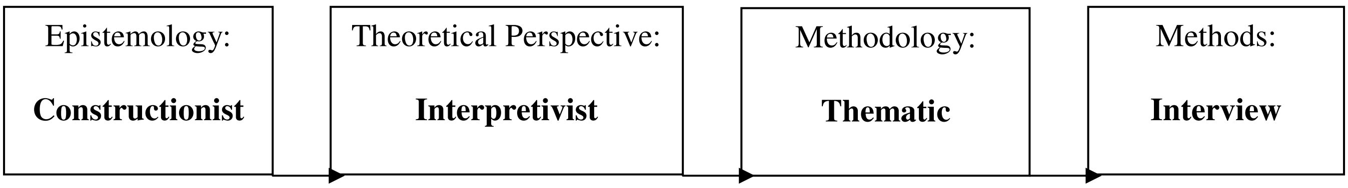
Because of the belief in a means-end dichotomy, accounting researchers take as given and natural a current institutional framework of government, markets, prices and organisational forms. Questions about the goal of a decision-maker, firm or society are seen as outside the province of the accountant (Chua, 1986, p.610).

The use of interpretivism, whilst not conventional in mainstream accounting and finance research, is warranted in this case because the present research assumes that both reality and knowledge are socially constructed, and hence operate within a dynamic context. The present study of accounting in action - by moving research into the life-world of practitioners in practice through an interpretive perspective - provides a mechanism to evaluate and potentially change institutional structures and influence policy development at the macro-level. An interpretive focus will assist in developing a deep understanding of the research questions as discussed in the available literature, and in particular surrounding the practical perspectives of practitioners, whilst simultaneously pointing to the importance of answering such questions. The interpretivist theoretical perspective underpinning the current research reflects this objective of gaining practitioners' perspectives of the Australian insolvency legislation outside of a predetermined framework. However, it should also be acknowledged that this theoretical framework is accompanied by limitations: given the dynamic social and accounting reality, such meanings surrounding insolvency practitioners' perspectives will effectively be constituted by their changing social, political, legal and historical contexts (Chua, 1986). In particular, research outcomes will need to be located within the parameters of the relevant environmental context, such as how a time of crisis (for

example the 2007 global financial crisis) affects the interpretation of findings, as well as the risk of the researcher's own subjectivity and interpretive bias. These limitations will be discussed in more detail later in this chapter.

It is hoped that by supporting an in-depth understanding of the practical constraints and barriers to restructuring, this study will contribute to furthering existing legislation surrounding the Australian corporate-rescue regime. Policy-makers' current focus on corporate rehabilitation provides the opportunity to foster an environment conducive to corporate rescue, and thereby reduces the likelihood of corporate collapse through reconceptualising the process of rehabilitation. That is, it could potentially facilitate corporate rehabilitation accountably and expertly, whilst maintaining fairness and efficiency. This is primarily the reason for this study's use of an open-ended qualitative research methodology. This chapter will also examine the assumptions and objectives underpinning the proposed research to highlight the benefits of using qualitative research methods. As outlined in Figure 3, the methods selected have been influenced by the theoretical framework identified for the development of knowledge and the philosophical assumptions behind the research design (Crotty, 1998).

Figure 5: Selection of Methods



RESEARCH DESIGN

This section will outline the use of a qualitative design and identify the research technique as an interview study. This research seeks to develop an in-depth view of the key areas and themes that practitioners identify as fundamental barriers to corporate rehabilitation in practice. The epistemological assumptions embedded in the present research are accounted for in a qualitative design, as seeking in-depth information from participants in the system of relevance, inherently supporting a constructionist framework. In this regard, it can be seen that for the purposes of this research, the qualitative design represents an ideal approach to enhancing understanding of the complexities surrounding practitioner perspectives of the insolvency legislation. The data will generate a useful practical insight into the perceived operating constraints of the current creditor-friendly Australian legislation, as well as providing a perspective on the validity of the drivers behind a current push for the adoption/transition to a more debtor-friendly corporate rescue framework, such as Chapter 11 in the United States.

The present qualitative methodology is justified by the need for understanding the complex determinants to the research questions, which would be unattainable through quantitative research. Within the realm of qualitative research, any method that attributes a pre-established framework onto the data would similarly restrict its interpretation, thus ruling out such potential approaches as content analysis. Further, as previously discussed, accounting research is traditionally limited in its ability to consider complex questions from frameworks outside the assumptions of quantitative research, further justifying the need for qualitative approaches to data collection and interpretation (Chua, 1986).

Qualitative research methods in social research have a rich and long history as a fundamental source of knowledge. In particular, qualitative research involves the investigation of individuals and groups in their social setting. Qualitative studies thus form the best mechanism to facilitate research that seeks to understand and investigate the feelings, thoughts and experiences of insolvency practitioners as participants within the operational context of the Part 5.3A legislation. For the purposes of this research, a number of different types of qualitative research designs were considered, with the most suitable design determined to be a thematic-analysis approach influenced by grounded theory (Glaser & Strauss, 1967; Strauss & Corbin, 1990). Such an approach to research design allows the researcher to extract the personal meanings of insolvency practitioners' practical experiences in the context of the corporate-rehabilitation framework and legislative environment. This in turn will provide the systematic grounding to gain insights into practitioners' perspectives of the operation and effectiveness of the legislation, with the research method benefiting from an absence of strong preconceptions or fixed hypotheses.

Grounded theory is a qualitative research approach suited to theory development (Strauss & Corbin, 1990); that is, theory is grounded in empirical observations within a practice. The approach uses a systematic set of procedures to develop an inductively derived theory that arises from the data. This is in contrast to deductive research, in which a theory is tested using mostly quantitative research methods. Grounded theory thus inductively develops a deep understanding of the phenomenon of interest (Strauss & Corbin, 1990). The basic idea of grounded theory is to analyse data and "discover" or

label variables (e.g., categories, concepts and properties) and their interrelationships. Research continues until "data saturation" is obtained, and no new concepts arise from the collection of data; at this point, the theory is complete.

To complete a study based on grounded-theory techniques is a time-consuming, complex and intense exercise. However, the inductive nature of grounded theory also gives rise to its technique of thematic analysis as a means to approaching data, without the formality of the full range of grounded-theory techniques, such as theoretical sampling. Therefore, the present research will be informed by grounded theory, but will use thematic analysis as its primary data-analysis technique, and will not formally attempt to engage in theoretical sampling. Using thematic analysis in this way is justified because it can be considered a research approach in its own right (Braun & Clarke, 2006). Thematic analysis occurs when a researcher searches for themes, both between and within participants, that are important to the topic being researched (Daly, Kellehear & Gliksman, 1997). The technique of thematic analysis identifies patterns in the data, and these emerging themes then become categories for analysis (Fereday & Muir-Cochrane, 2006). The present research will draw on the thematic-analysis approach described by Boyatzis (1998), which is outlined in more detail in the section of this chapter regarding data analysis.

The objective of the proposed research is to use insolvency practitioners' accounts to develop an in-depth assessment of corporate-rescue effectiveness and barriers relating to the Part 5.3A voluntary-administration rehabilitation regime. By conducting interviews with each participant and using open-ended questions, which are exploratory in nature,

this study limits the degree to which participants are influenced by previous theoretical constructs (Strauss & Corbin 1990). The benefits of this open-ended questioning are likely to be the eliciting of dense and rich descriptions of practitioners' experiences and perspectives of the Part 5.3A procedure. Later-stage interviews are effective to check the content areas introduced through actively verifying the emerging theory with participants (Silverman, 2006). In addition, this method highlights the importance of using participants' own language to further ground the theory construction and add to the credibility of findings (Strauss & Corbin, 1990). A key focus of this approach is to ensure that the identified impediments to successful corporate restructuring are examined in sufficient depth and to appropriately "place" these barriers within the emerging theory.

However, whilst qualitative research lends itself strongly to the in-depth understanding of the subject matter and phenomena, the descriptive and unstructured nature of the data-collection methods raises challenges surrounding external and internal validity (Guba & Lincoln, 1983). In that regard, consideration in research methods for the proposed topic will need to account for strategies that ensure the reliability and validity of the research methods; these will be addressed in the section of this chapter regarding research quality.

The specific method used in the present research was a semi-structured interview. Adopting the semi-structured interview design allowed for the emergence of a more complete picture of the research topic and facilitated the opportunity for participants to guide the direction of the interview (Smith, 1995). A semi-structured interview is

justified by its ability to capture the complex data that was required for the present research questions. Further, the interpretive nature of inquiry in the present research is consistent with the selection of a semi-structured interview, which introduces a constructionist epistemological and ontological framework (Chua, 1986). In conclusion, the research design chosen for the present study will leave the author in an ideal position to answer the research questions and provide the tools for rigorous data collection and analysis, and the development of conclusions.

ETHICAL CONSIDERATIONS

Several ethical issues warranted consideration for the present research, and have been the subject of approval by the University of Wollongong Higher Research Ethics Committee (Appendix B). First, it was necessary to ensure that participation in the study was completely voluntary, and that no form of coercion was used while attempting to recruit participants for the project. Participants were advised verbally and in writing (through the participant information sheet and consent form, Appendices C and D respectively) that their participation was completely voluntary and that they would not be discriminated against in any form should they choose not to participate. Similarly, participants were advised that they could withdraw their consent at any time during the study (including after the interview) without penalty or prejudice.

The second ethical consideration was privacy. Information obtained from the semi-structured interviews was kept confidential to protect the privacy of participants. In this way, any form of published data (e.g., interview quotes) would not be identifiable with a particular participant. Pseudonyms are used in the presentation of data as a means of protecting participants identify. As the insolvency field is predominantly male and there

was only one female participant, a number of gender-neutral names have been used as pseudonyms to protect the privacy of the female participant.

The third ethical consideration is honesty. It was necessary to ensure that informed consent was obtained from participants. This was achieved by a clear participant information sheet and consent form.

Last, the research needed to ensure that the analysis and reporting of results was conducted in an ethical manner. Specifically, results of the project would need to be published and presented in a way that accurately represented the findings of the project. Participants of the study were posted a brief summary of the findings as a way of thanking them for their participation.

METHODS

Sampling

The study identified a sample of insolvency practitioners who were recruited using a purposeful approach to sampling (Patton, 2002). Purposeful sampling allowed the researcher to specifically target participants who were relevant to the research question (Silverman, 2006). The sampling population was insolvency practitioners including registered liquidators, official liquidators and legal practitioners specialising in insolvency law. These professions all overlap to meet the population criteria for experts in the field of insolvency and business failure. Although the nature of the roles played by liquidators and legal practitioners specialised in insolvency law are distinct in their aims and objectives, it was important that the population sample could capture these

different perspectives and data was analysed accordingly to understand the potential differences these perspectives may bring. Snowball sampling techniques were also considered should purposeful sampling not engage enough participants, and three participants were recruited in this manner. Participants were recruited from the Sydney and Brisbane areas so that the researcher could access a location convenient for the participant to be interviewed.

Recruitment Strategies

Participants were approached for their participation through posting a letter of invitation (Appendix E) that included the participant information form, the consent form and a reply-paid envelope. Once participants consented to participate in the research, they were contacted to arrange a convenient time and location for the interview.

Participants for the study were divided into 1) registered liquidators and official liquidators; and 2) legal practitioners specialising in insolvency law. The Insolvency Practitioners Association of Australia (IPAA) website has a register of professional service firms in this area (accounting and legal firms), from which one can then see the individual practitioners at the firm. It is also possible to run a "find a practitioner near you" function on the IPAA website, which enabled the researcher to identify further practitioners for the research sample.

From there, the practitioners' names (other than legal practitioners) were checked in ASIC's Professional Register to see whether they were a current registered liquidator or official liquidator, and find the date that they commenced registration. Whilst registration commencement is not necessarily a full reflection of experience, given the

scope for significant work experience in the field prior to registration, this provided a baseline indicator of the practitioners' experience. Participants were selected if they had been registered for more than four years, to ensure that they had adequate practical experience to contribute to the research.

Procedures

Instruments

The primary instrument for the present research was an interview guide (Appendix F), which helped the researcher go through the relevant topics for the interview while also providing scope for participants to consider further information and expand upon their responses with tangential commentary (Patton, 2002). The interview guide commenced with the collection of demographic information and was followed by open-ended questions that directly mapped onto the research questions for the present project.

Data Collection

Once an interview began, participants were reminded about their ability to withdraw from the study at any time without penalty or prejudice, and the interviewer asked for their permission to record the interview audio for the purposes of data transcription and analysis.

Throughout the course of each interview, the researcher followed the questions on the interview guide and ensured that all broad topic areas were covered. At the same time, the researcher probed for further information and allowed participants to direct the interview and discuss in depth topics of relevance to them. To facilitate this process, the interviewer used such strategies as building rapport with participants and encouraging

them to provide as much information as they saw fit using open-questions (Silverman, 2006).

Data Analysis

Interviews were transcribed verbatim from the audio recordings. From each transcription, data was analysed through the development of an initial tentative coding scheme, a form of data reduction (Miles & Huberman, 1994). This inductive process sought to reduce the data into categories that were common across and within interviews, filtering out insignificant text, and beginning to construct a framework for revealing the main themes of the findings (Patton, 2002).

The present study used thematic analysis as the method to make sense of the findings. While this approach is derived from grounded theory (Glaser & Strauss, 1967; Strauss & Corbin, 1990), it can be considered a data-analysis method in its own right. Boyatzis (1998) describes the approach of coding for thematic analysis as one where important information is identified prior to the process of interpretation based on inductive reasoning. Codes are thus able to capture rich ideas about the phenomenon of interest, and the identification of themes can then emerge. A theme is therefore something that encapsulates the patterns that have emerged in the data and assists in the interpretation of relevant aspects of the research phenomenon (Boyatzis, 1998).Thematic analysis thus provided the means to develop an in-depth understanding of the interview findings.

Data analysis began after the first interview and continued until a meaningful interpretation could be made from the themes developed. Data was initially sorted into tentative codes, which over time became more definitive until they resulted in the

themes that will be presented in the following chapters. Throughout data collection and analysis, the researcher also kept memos to track the development of themes and aid in the analysis of data.

To track and save ongoing data analysis, the computer software NVivo 10 was used. This software aided in the recording of data-analysis processes such as labeling codes and conducting Boolean searches during later interpretive analysis, thereby increasing the efficiency of the data analysis (Bringer, Johnston, & Brackenridge, 2004).

It was considered that the themes be counted and presented from the perspective of how many participants endorsed each theme. However, there are a number of contradictions to such an approach. First, there was no attempt made to capture a representative sample in the present research, so applying statistical analysis to the findings would be misleading. Second, the attempt to quantify qualitative data forms a deductive approach to data analysis, which is different from the inductive way in which the present research aims have been framed. Any calculation of the representation of themes across participants is also based on different epistemological assumptions from interpretivism, which seeks a deep understanding and is a shift away from the objective assumptions behind quantification (Crotty, 1998). For these reasons, there was no frequency count of how many participants endorsed each theme.

RESEARCH QUALITY

The open-ended and iterative nature of qualitative enquiry (Miles & Huberman, 1994) means that the researcher is in many ways not separable from the interpretation of findings, and neutrality is thus not possible. The risk of using qualitative research is that

the researcher needs to free him/herself from preconceptions in the collection and analysis of data (Patton, 2002) to truly develop the data inductively. One way to approach such a dilemma is to consider a reflexive approach to research (Woolgar, 1988). Reflexivity in the present research involved speculating and continuously reflecting upon how the researcher affects the collection, analysis and representation of findings (Patton, 2002). This section will therefore outline some information regarding the researcher's experiences and insights regarding the research topic, and describe the researcher's use of a reflective journal.

Researcher Experience

This section will explain my own construction of the research phenomenon and acknowledge how this affected the inquiry, thereby enhancing the credibility of the data interpretation. Such an acknowledgement can make it clear how my experiences, including working in the insolvency field and in the financial-services industry, may have contributed to the way the data was collected and interpreted.

My professional background has included working as a chartered accountant in the insolvency profession for four years, including on high-profile corporate collapses in Australia. This included the opportunity to recognise first hand the extent of enterprise-value destruction and the significant economic and social cost associated with corporate failure. Subsequently, I spent almost 10 years working in the banking and finance sector, including senior debt involvement in the successful restructuring of several large and public companies. This has included working closely with company boards, private-equity and insolvency-advisory firms to maximise the likelihood of corporate rehabilitation and value extraction of distressed companies.

It has been in the context of this exposure to the current insolvency framework in Australia that both the facilitators and barriers to the successful rehabilitation of companies have become apparent. Whilst my experience indicates that the Corporations Act Part 5.3A legislation is an effective foundation to facilitate the restructure of Australian companies, increased scrutiny of insolvency legislation following the GFC has highlighted that this restructuring process follows a significantly different trajectory to that undertaken in other jurisdictions, such as the United States. In that regard, the current research seeks to take advantage of my commerce and law background and experience to gain an in-depth understanding from insolvency practitioners of their experiences working within the existing Australian framework.

These experiences, while providing a foundation for knowledge related to the present research topic, also has the potential for research bias. This includes differing priorities that the researcher personally places on competing economic and social objectives, as well as certain assumptions about the world and society. For example, my background in the banking and finance sector has the potential to result in an inherent tendency to value capitalist ideologies over socialist ones. This in turn has implications for the critical analysis and hierarchy of priorities that need to be considered to facilitate the restructuring of companies amongst competing needs, such as those which influence the creditor- or debtor- friendly approach discussed in the literature review. Furthermore, my experiences have undoubtedly been influenced by my workplace environments, reporting superiors and educational experiences to date, which all have the ability to result in potential bias. A broader bias of my research that is embedded in the very way

my research questions are framed is that it is beneficial to have a higher rate of successful corporate restructures. Whilst such an aim is in my opinion valuable, it is nonetheless grounded upon an economic and social aim that is not value-neutral.

Reflective Journal

Throughout the research process, a reflective journal was maintained that was used to outline my thinking regarding the process of research and data collected. Such a journal served as a means to highlight – and therefore bracket, and ideally reduce – bias towards the analysis and interpretation of findings.

CONCLUSION

This chapter has presented the methods used in the present research to understand the perspective of insolvency practitioners towards corporate-restructuring practices in Australia. The present methodology is informed by an interpretivist framework and uses a qualitative approach to data collection through a semi-structured interview. Ways in which the potential bias of qualitative research has been addressed have also been discussed. The next chapter will present findings from the interviews conducted.

CHAPTER 4: OBJECTIVES AND OPERATION OF CORPORATE REHABILITATION IN PRACTICE

INTRODUCTION

This chapter outlines the findings from interviews with insolvency practitioners. It describes their experiences in practice using the Part 5.3A voluntary-administration legislation in working with and rehabilitating insolvent companies in distress.

DEMOGRAPHICS

Participants in this research consisted of 10 registered/official liquidators and five insolvency lawyers, who had been registered for a period of more than four years. This section will outline key background and demographic information in relation to the interview participants and the nature of their practice and experience in the insolvency field.

Participants had been registered for an average of 12 years and had been practising for an average of 18.4 years. The client revenue that participants worked with ranged from zero to 1.8 billion dollars. All registered/official liquidators had experience in the areas of voluntary-administration and liquidation, and 13 of the 15 also had experience with receivership and advisory work. All five insolvency lawyers had experience with insolvency law, and three also had experience with bankruptcy law. Fourteen of the 15

participants were male, which is roughly reflective of the gender distribution of the field.

Table 3: Summary of Participant Demographics

Participant	Registration	Years Registered	Years Practicing	Client Revenue	Areas of Practice
Lee	Registered / Official Liquidator	21	25	\$10.0M to \$100.0M	Receivership, VA, Liquidation, Advisory.
Leslie	Registered / Official Liquidator	8	20	\$0.0M to \$200.0M	Receivership, VA, Liquidation, Advisory.
Shannon	Registered / Official Liquidator	6	16	\$1.0M to \$1.8B	Receivership, VA, Liquidation, Advisory.
Dale	Registered / Official Liquidator	18	28	\$25.0M to \$1.5B	Receivership, VA, Liquidation, Advisory.
Philip	Registered / Official Liquidator	6	14	\$10.0M to \$500.0M	Receivership, VA, Liquidation, Advisory.
Julian	Registered / Official Liquidator	5	26	\$0.5M to \$5.0	Receivership, VA, Liquidation, Advisory.
Cameron	Registered / Official Liquidator	5	14	\$20.0M to \$500.0M	Receivership, VA, Liquidation, Advisory.
Evan	Registered / Official Liquidator	12	21	\$5.0M to \$20.0M	Receivership, VA, Liquidation, Advisory.
Taylor	Registered / Official Liquidator	19	21	\$0.0M to \$5.0M	VA, Liquidation.
Jamie	Registered / Official Liquidator	9	13	\$0.0M to \$50.0M	Receivership, VA, Liquidation, Advisory.

Alex	Lawyer	15	15	\$0.5M to \$100.0M	Insolvency & Bankruptcy Law
John	Lawyer	18	20	\$5.0M to \$1.5B	Insolvency & Bankruptcy Law
Sam	Lawyer	5	9	\$50.0M to \$500.0M	Insolvency Law
Adrian	Lawyer	24	24	\$1.0M to \$200.0M	Insolvency & Bankruptcy Law
Chris	Lawyer	9	10	>\$10.0M	Insolvency Law

Participant Response to Research

Participants who agreed to be involved with this research appeared to have a strong interest in the operation and advancement of the Australian insolvency legislation. They viewed the rehabilitation framework as fundamental not only to the practice of insolvency and the profession, but also to the efficient and effective operation of the Australian economy and broader society. A number of participants also expressed their interest in the research as being driven by barriers they regularly encountered in working as insolvency practitioners, and were happy for the chance to express their views in the forum as to how these could be addressed.

> *"I was very interested in your topic and I'm sure we'll go onto it, but it's very frustrating in the sense that you see what happens in other jurisdictions, and we just have some clunky rules here and you can sort of see the distress doesn't*

need to be the distress that we work out in the Australian market, it can be otherwise." (Cameron)

Participants also expressed enthusiasm throughout the interview process that the questions put forward were pertinent to understanding the corporate-rehabilitation framework in Australia. Discussion included challenges experienced by practitioners in the industry and potential mechanisms for improvement.

LEGISLATIVE AIM

This section will outline participants' perceptions of the objectives of the Part 5.3A legislation and the priority in which the aims of the legislation are pursued. It will also discuss why, in practice, the stated objective of rehabilitating a company (or as much of its business as possible) is often given lower priority than the pursuit of the best outcome for creditors.

Difference Between Part 5.3A Objectives and Practical Application

The participants' view of the underlying objectives of the Part 5.3A legislation and what the broad aim of the legislation should be in practice were aligned. That is, a focus upon the continuation of the company - or as much of its business as possible - and the pursuit of a better return for creditors were considered to be the objectives.

"Well, I think it is actually pretty well expressed in the legislation itself. It's got two essential aims. It's either to contemplate the continuation of the corporate entity in a better form than the benchmark, which would be what the wind-up scenario would look like. The other limb is that even if you can't have the

> *business survive, if you can utilise the moratorium provisions of the VA to have a better result, let's say sell down the underlying assets or business as a going concern within the VA period. And notwithstanding that you ultimately go into liquidation, at least you are getting a better result for creditors than if you went straight into the liquidation." (Evan)*

Some participants questioned the legislative objective of the company itself surviving or being restored to financial health. Instead, they advocated for the objectives to be focused on ensuring the survival of a viable business, with the potential for a deed of company arrangement to rehabilitate an insolvent company being just one mechanism to facilitate this outcome.

> *"There is this concept in the legislation about saving the company itself, and I guess I sort of ask, 'What does that mean?' More often than not, if a business makes money…someone wants a business if it can make a profit, maybe it's had losses in the past or had the wrong capital structure and it's actually a viable business…someone wants it. What normally happens is that a business gets sold to a Newco. Really, how does a DOCA give you a better chance of rehabilitating as opposed to the sale of a business? I would argue not a whole lot really. Often it means that the existing directors' and owners'…[they] get to keep it. That's about all it facilitates." (Phillip)*

Indeed, a number of participants highlighted that given the hierarchy of stakeholder claims corresponds to the potential benefit and risk associated with a company's

success, a sound rationale existed for the primary consequence of failure being borne by equity.

> *"The idea though that a lot of this comes from equity if you like, I will collectively call them equity, who despite the fact that they are equity and get all the upside opportunity, that they mismanage the business and they want everyone else to pay for that as a way of recapitalising their business. I don't think that is acceptable and should not be accepted. There is a ranking. That ranking reflects the risk and the return." (Taylor)*

This brought into question whether the primary objective of Part 5.3A for the rehabilitation of an insolvent company was inconsistent with this hierarchy of stakeholder claims, and should instead prioritise the maximisation of creditor returns.

> *"Clearly, the aim when a company no longer has equity value should be to preserve value for creditors. I think that should be broad and should not be constrained in terms of how that is achieved, but it should be preserving and maximising the outcome for creditors. Generally speaking, creditors like to see their interest converted into some form of cash, and generally speaking their interest is not for a long-term work out." (Dale)*

Significantly, a majority of participants commented that despite the stated aim of the Part 5.3A legislation of saving the company and underlying business, this aim was often relegated as secondary to the pursuit of this return to creditors under the framework.

"I think in practice, despite the aims articulated under the legislation, that reality inevitably defaults to the objective of providing creditors, including unsecured creditors, with a better outcome than they would achieve in a liquidation scenario and to, where possible, allow the continuation of trading entities as a going concern." (Alex)

"Look, I think in practice it's about getting the best possible return, primarily for creditors and then following that all other stakeholders, in a transparent and lowest cost of process way." (Philip)

This creditor focus is largely due to the operation of the Part 5.3A legislation, which requires creditors to ultimately vote and decide on the outcome of the voluntary-administration process. Participants identified that this creditor reliance within the rehabilitation framework created an overriding creditor-return consideration to the likely success of any restructure proposed under voluntary-administration.

"I guess that the mechanism - if you step away from the object as set out in the Act and look at the mechanism itself - as to how you get an arrangement approved, the administrator's job is still to demonstrate that the creditors would be better off under the proposal compared to liquidation or alternatives. So the other objective does take a back seat to the return to creditors, given that if you don't get over that obstacle and show that it is in creditors' interests, then

> *ultimately your arrangement can be challenged and set aside, if it gets approved in the first place." (Taylor)*

The perception that the default position did not focus on the objective to rehabilitate the company itself was raised as an area of concern by those participants whose experience and background focused on debtor-side advisory and appointment work. These participants argued that if there was a sensible commercial rationale for the company continuing in existence, then there was merit in saving the company as a whole.

> *"If you look at the two objectives of the Act, the idea that it allows a company to continue in existence is a sensible objective, but in practice I think that objective is often secondary or tertiary in terms of what people find themselves doing in that regime and arena. So, I think it very very quickly morphs into, 'How do we get cents in the dollars for everyone and how do we protect employee entitlements?', not 'How do we actually allow this company to continue in existence if in fact there is a sensible business case for salvaging this company?'. The latter is what I think it should be, I think there should be a rigorous assessment around does this company deserve to continue, and if yes, how do we make that happen? Quite often, the idea that you just go and sell it to the highest bidder and get out is actually counterintuitive to that objective, to be honest." (Shannon)*

This ideological viewpoint was contrasted with other participants whose work was less debtor focused, who suggested that a focus on maximising the chance of the company

itself emerging from administration had the potential to actually be detrimental to the broader economic objectives:

> *"I am not sure that the goal of having the company continue to exist as it sits at the moment sits very well with that object…because on one view that objective almost seems to be an objective of pardon. There is research that says that one of the most effective ways of improving the productivity in an economy is in fact getting rid of those unprofitable, non-viable entities." (Taylor)*

In practice, participants reported that the voluntary-administration framework played an important role in bringing insolvent companies to a decision juncture. In that regard, participants acknowledged that the Part 5.3A process provided a valuable mechanism to pursue an alternative outcome to liquidation.

> *"The prospect of an orderly winding up of the company with a reasonable return to creditors, or some return to creditors, still often is a lot better and a lot more efficient way of dealing with the assets and finalising the affairs of the company than allowing it to continue on down a path with no structure and continuing further losses being incurred. The consequences of personal liabilities for the directors and those sort of things that go with it, you can often end up with a much worse disaster than you would have if you [had] dealt with the problem a little bit sooner. You have got the prospect of convincing companies to deal with it sooner whilst they have that chance of some*

alternative other than the worst-case scenario of liquidation and bankruptcy and other things that go with it." (Paul)

Whilst the success rate of companies restructuring under the legislation was less than ideal, participants saw merit in providing breathing space to enable a thorough assessment of whether there was value in restructuring a potentially viable business.

> *"I think [voluntary-administration] is designed to create a status quo to see if a business or company can be saved. I think in practice the number of companies that end up back trading viably [after] having been restructured via a deed of company arrangement or some other means is very small, and probably a lot smaller than was intended when the path was created. But I don't necessarily see that as a failure of the Part 5.3A legislation. One, because you get an opportunity to have a go at a restructuring even if it doesn't come about and no proposal can be put up…you still have a chance to save the business itself." (Adrian)*

Participants were shown to support the objectives of the legislation, albeit with a priority focus in practice on achieving improved creditor realisations rather than salvaging the corporate entity. This was in contrast to the objectives under the legislation, which focuses upon rehabilitation of the company, or as much of its business, followed by improved creditor returns as an outcome. This was found to be a function of the creditor driven conclusion to the voluntary-administration process, with

the potential outcome for the insolvent company contingent on the likely comparative return to creditors.

Creditor-outcome Focus

Participants contrasted this creditor-outcome-focused approach to corporate rehabilitation of Australian companies with the focus in other jurisdictions, where primacy of importance was placed on how the company could be salvaged. There was also recognition of a broader set of factors that the administrator was obliged to consider under Part 5.3A, rather than just an immediate rescue focus.

> *"I think there is a contrast between the Australian system and the American system, where the American system is more looking at saving the company, so more debtor-friendly if you like. Whereas in Australia we tend to have a view, 'well, the bank can appoint or we need to appoint a VA in the interest of the creditors', so we tend to have a greater focus on how we are going to get the money back to the creditors. I suppose the American system is more 'how can we save the business?', with less emphasis on insolvent trading and creditor positions and all that sort of stuff. Obviously they've got to be looked at and dealt with at some point, but they start at a different point." (Lee)*

> *"In relation to the rescue culture, in the US and abroad this seems to be a far more in-the-spotlight objective, whereas in Australia it seems much more of a creditor-focused process. So getting the best return for creditors rather than*

keeping the company alive. My view is, that is a noble objective. It's what it should be." (Julian)

However, participants acknowledged that the creditor-driven process under the voluntary-administration framework risked promoting short-term and narrow objectives that were incongruent with the rehabilitation of viable insolvent companies. In particular, such outcomes were likely to be influenced by such factors as the quantum and timing of returns to creditors.

> *"I think there is a tension between those two objectives, because people generally, when they are dealing with the company and they are owed money, they generally need that to be converted into cash. They generally don't want that rolled into a long-term equity interest or deed of company arrangement which is realised in a classic two-, three-, four-year timetable. So creditors generally need to convert it to cash, which generally drives a sale of some form. Often businesses that are down, a sale in that point in time will not maximise the outcome for the stakeholders. I see that as just a natural tension that sits between what happens when businesses get into stress, who are the stakeholders at that point in time and the nature of the stakeholder claim, [which] is not a long-term interest, it is more a short-term interest". (Dale)*

Some practitioners also questioned the extent to which in practice the legislation truly facilitated a creditor-aligned outcome, particularly in the smaller market segment.

Participants speculated that the creditors of smaller businesses were less likely to be aware of and engaged with the voluntary-administration process.

> *"I think there is a bit of a misconception, to be honest. It is considered creditor-friendly because creditors vote on the outcome, but generally speaking it depends on what part of the market you're at. Creditors often aren't all that well informed and are often not all that engaged in the process. The administrator is usually appointed by the debtor. The debtor is the most engaged in the process, normally, certainly at the smaller end, which is in reality where the vast majority of VAs happen, and if there's no secured creditor or a small secured creditor. So I get that on paper it looks like a creditor-controlled process; however, I am not sure that in reality that's always practically how it works." (Philip)*

Participants were of the view that the primacy of creditor-focused outcomes was a function of the environment in which insolvency operated in Australia and how it was applied in practice. They reported that the importance of creditor participation and determination was a concept firmly entrenched in the Australian culture and custom, rather than just the legislation itself. Cultural considerations will be referred to in more detail in Chapter 5.

> *"The legislation itself I think by and large is fine, with a number of exceptions, but I don't think it very often actually achieves what it sets out to achieve. But I think that is more cultural and environmental, not necessarily a problem with*

the legislation. You are never going to get a perfect answer and I think you can only do so much with the letter of the law, and a lot of this is about how it is practised". (Shannon)

Practitioners identified that despite this focus on creditor outcomes, an emerging trend of creditor behaviour was increasing commerciality in recognising the value of rescuing a business as a going concern and the potential for ongoing relationships.

"So the creditors have to vote on which way to go, and generally in my experience creditors are increasingly commercial at creditors' meetings. There is more of a sense of 'that could be me' than 'you stole the money from me' or 'you have done me wrong'. Also creditors think that if there's an opportunity for the business to continue in existence, again depending on the size of the relationships, they'll have someone to continue to trade with." (Leslie)

Over time, this has reportedly resulted in creditors recognising the value of considering alternative restructure proposals, rather than simply pursuing a liquidation process of nominal creditor realisations. Participants reported that this has often been influenced by historical experiences that have shifted creditor behaviour and willingness to compromise their debts earlier in the restructure, and thus provide an opportunity for the company to be salvaged.

"Senior creditors, and generally creditors, are now more familiar and comfortable with the way in which insolvency works. And many of them have

had experiences where they have received unsatisfactory or nominal returns at the end of the day. So I think people know where things are heading. If it looks like the company is going down that orthodox liquidation path, creditors are generally being commercial and proactive in saying, 'Look, well, I'm just going to make a commercial decision here, I'm prepared to take a haircut at an early stage. Even though it involves a bit of pain, it's likely to be less pain than I am going to experience if this process runs its course'. I think there is a greater awareness and a bit more proactivity in that respect." (Sam)

Where participants felt that creditor judgement fell short, however, was in the creditor's ability to assess and recognise the value of broader stakeholder implications, such as the good of the community.

"One of the things that we certainly discuss at a partnership level whenever we are involved in a substantial VA is actually going back to that purpose of 5.3A. And I think there should be more focus on things like keeping people employed and impact on the community. So I do think that there is an over-focus on creditors…to culturally get creditors to accept that as a creditor of a company in administration, they are going to get a lesser return because a community is saved, is a very difficult thing for them to get their head around." (Jamie)

Participants highlighted the challenge of gaining acceptance of broader stakeholder considerations in administrators' recommendations where there was conflict with the direct financial interest of creditors. Participants contrasted the rights of creditors to

pursue their own objectives with the absence of a clear mechanism to facilitate such potentially beneficial administration outcomes.

> *"I think if you give individual creditors rights, they are often entitled to act on those rights without seeing [their actions] wider impact upon enterprise value or going-concern value. So I think in that sense it's this individual creditor right versus creditors as a whole acting as a group." (Dale)*

The creditor focus on the voluntary-administration process was thus shown to create a broader spectrum of considerations in the rehabilitation process than just the rescue of the insolvent company. This section has identified the foundations of creditor participation in Australia to be cultural as well as legislative, which is a key driver for creditor objectives influencing the ultimate voluntary-administration outcome. Participants recognised a transition to greater commerciality exercised by creditors as they became more familiar with the existing insolvency framework; however, this fell short of considering broader stakeholder implications such as community impact in determining outcomes for insolvent companies.

Success Rate and Rehabilitation Definition

The anecdotal evidence from participants on the success rate of insolvent companies successfully emerging from the voluntary-administration process in a rehabilitated form indicates that a majority of companies proceed into liquidation.

> *"The number of companies in my experience that are able to successfully emerge through the voluntary-administration process would be less than 5%. It's a very low level, unfortunately." (Lee)*

However, participants were of the view that this low rate was not reflective of a failure of the legislative framework, but was rather a misrepresentation of the statistics. The consensus from participants was that the legislation was more effective in practice once people looked beyond what happened to the corporate-entity shell and considered the survival of the underlying business.

> *"I think that is a fundamental misinterpretation of the numbers, and one of the things that happens is that a lot of the companies and corporate entities that go into voluntary-administration end up in liquidation. What that in my view is primarily a result of, is that a company appoints a voluntary-administrator and enters the voluntary-administration process, and then as a result of that process the business out of the company is sold. Or part is sold and the corporate shell at the end of that then with no business in it ends up going into liquidation. The big mistake that a lot of people make in interpreting some of these statistics is that in order for a restructure to be successful, there must have been a deed of company arrangement executed, which isn't true." (Leslie)*

> *"Well, it gets down to noting of course that the ability to be restructured and survive is only one valid aim of voluntary-administration. The other valid aim is to yield a result better than going straight into liquidation. I mean sometimes an*

effective restructuring could be the sale of the underlying business and assets to a third-party entity. If, for example, notwithstanding that the legal entity left behind is put into liquidation, that means continuity of employment for a number of employees. The business is still contributing to GDP, and for the benefit of society generally, that could be well deemed as a successful restructuring." (Evan)

Participants were of the view that how the term "rehabilitation" was defined was a key determinant of interpreting the success of the legislation and the insolvency statistics themselves.

"So, drawing a distinction between whatever the statutory regime is being applied to the corporate shell can have zero bearing or zero relevance to the actual restructure or actual rescue of that particular business. And I think this is where public perception breaks down…they simply hear that the corporate shell is in liquidation, which is a disaster. Well, those are corporate entities or corporate shells, which doesn't necessarily equate to businesses." (Leslie)

Participants reported that the high number of companies that proceed into liquidation from voluntary-administration reflected a lack of filtering at the appointment stage and the ongoing use of the process as a default mechanism.

"So the VA process is a quick process of getting the company away from the directors and stopping the insolvent trading and putting it in the hands of the

insolvency practitioner, who then makes a decision after he's assessed the business as to what should happen. Objectively if you look at it you'd say, 'Well, all those companies on that side of the room should never have gone through the VA process because there was never a hope in hell of them being restructured,' but they're all going through it and therefore the level of deeds of company arrangement is very low." (Lee)

There was agreement amongst participants on the importance of administrators gaining an understanding of the company, its underlying business and what the directors were seeking to achieve in determining whether the Part 5.3A regime should be pursued. This in turn tended to be a key determinant of the likelihood of achieving a successful outcome in the process.

"When talking to directors and talking to management who are contemplating going down this road [voluntary-administration], the very first thing I will generally ask is, 'What do you want to achieve through this process, where is your mind at and what is it that you want to get to?' Now if the answer to that is, 'I just want to get out, the industry is completely different to what it used to be, I am finding it very hard to navigate my way through the commercial world at the moment because my business is no longer relevant to my target population whatever it might be.' In those circumstances, or if the financial distress is so dire, I generally recommend to them, 'Don't bother with voluntary-administration.' The reason for that is because voluntary-administrations are

expensive. Effectively, voluntary-administration is an exercise you embark on with a view to restructuring a company." (Sam)

A historical factor that participants identified as distorting the voluntary-administration success statistics was the role played by the legislation as a quick appointment regime for directors of insolvent companies.

"When it initially came out I think it was used as a quick and cheap way to get a company into liquidation but with the changes to the law for entering into CVLs [Creditors' Voluntary Liquidation] and the way they've made it easier has meant that administrations aren't used for that purpose as much." (Adrian)

Changes to the Creditors' Voluntary Liquidation (CVL) legislation in 2007 made it procedurally easier for companies whose directors had already reached the conclusion that the business was not salvageable or were not seeking rehabilitation to simply go straight into liquidation. These legislative improvements corresponded with a sharp decline in the unmeritorious use of the voluntary-administration process in the ASIC statistics.

"Often these guys come too late and if they come too late you can't do much about it. So they are screaming, 'I'm on the hook for insolvent trading, I want to get off it now,' and it wasn't until they changed the creditors' voluntary rules that you could accelerate what was otherwise a 21-day or more process to get the company to liquidation. Once the members had passed the resolution to

liquidate the company, the effect was immediate, and then they were off risk from trading whilst insolvent. I think that these CVL changes certainly have cleaned out many companies that didn't have any prospect of going through an administration, and some that could not even afford the cost of going through an administration." (Cameron)

Notwithstanding these improvements to the CVL appointment process, some participants were of the view that the success statistics continued to be affected by companies entering voluntary-administration simply because of the ease of the process.

"I think people are just probably still using the VA, because you can basically come in today, you talk to me and I talk to you. You have a meeting with directors, I'm appointed, I give you consent, off it goes. It's done. Whereas the CVL option is still a little bit longer." (Lee)

Participants also highlighted the significance of correctly selecting the appropriate appointment type from the outset into voluntary-administration or CVL, which has implications for the economic cost associated with the insolvency process.

"The CVL process is also a materially cheaper process, [and] so [is used] when a director comes in and when there is no prospect of either utilising the moratorium process in the VA to improve the result or alternatively there is no real prospects of restructure. My firm and most others would say, go the CVL

route because it's cheaper, because we don't have the same detailed reporting obligations and the cost of convening meetings of creditors." (Evan)

Participants also sought to point out that the large majority of insolvency appointments occurred with very small businesses, where often there was very little to work with in terms of rehabilitating the company or underlying business:

"Firstly, that's just where the most in volume is, where the most failures are, most businesses in Australia are small businesses. Small businesses, you know, there is probably a higher propensity of them falling over, because they are often run by people with no financial background, they don't keep good records, they don't keep themselves well informed." (Philip)

In particular, participants referred to the distortive impact on success statistics identified due to the increasing prevalence of phoenix-type companies, which have been responsible for the significant growth of the insolvent-company volume.

"I mean the phoenix activities which we see so much of, clearly [have] a contributory function in distorting the Part 5.3A stuff. So as an overview I think that what it appears to be being used for, is for directors to bump a company when they are about to get personal liability for insolvent trading, or when they get a section 222 notice from the Australian Tax Office to make them liable." (John)

Another distortive factor in analysing the insolvency statistics is the potentially significant impact of the number of companies that have been using the corporate structure to register what effectively amount to "personal services" companies.

> *"I also think that there are a lot of very small businesses who are out there, effectively sole traders who are tradesmen and things like that and have two, three, four, five employees. Or if they are a sole employee - obviously the construction industry is a classic example, where all the tradies are sole traders, which helps big builders get around various other things. So I see a lot of them and there [are] so many of those sorts of businesses on their own, they're employees. They are, to use the tax definition, basically income-services companies, for want of a better term. Their whole purpose is to get the income for the director because that's all he really works for. So there's a significant potential for a lot of the statistics of companies using this legislation to be somewhat clouded." (Julian)*

There was acknowledgement by participants that, based on anecdotal evidence and personal experience, the statistical rate of companies emerging from voluntary-administration was low. It was apparent, however, that participants did not regard such statistics as a reflection of the ineffectiveness of the legislation, given the objectives of a successful rehabilitation outcome as defined under the Act. That is, if salvaging the company cannot be achieved, the legislation facilitates the going-concern rescue and sale of the underlying businesses, or achieves a better return to creditors than liquidation. The findings attributed the statistical criticisms of voluntary-administration

to a misunderstanding of the legislation's objectives, the distortion of statistics by high-volume phoenix or "personal service" companies and ease of process entry. The importance of effective screening and filtering of distressed companies using the process was thereby identified as important for both the efficient use of the procedure and managing the costs of insolvency.

WHAT HAPPENS ONCE A COMPANY GETS INTO TROUBLE?

Once a company begins to get into financial trouble, several pathways can be taken in an attempt to restructure or salvage it. This section will discuss the importance of appointment timing and preparation in determining the success of restructuring insolvent Australian companies under the Part 5.3A legislation. It will then discuss the implications for the corporate-rehabilitation framework of the insolvent-trading legislation, and how this legislation interacts with both formal and informal restructuring of distressed companies.

Participants noted that the role of the insolvent trading legislation in the current environment was often pivotal to the appointment of a voluntary-administrator. The research highlighted the earlier identification of distress by directors or a company's auditors as critical to proactively and successfully pursuing formal or informal rehabilitation of a company.

> *"The insolvent-trading positions are intended to be, and perceived by the industry to be, a big stick, to make directors appoint voluntary-administrators, which in my view*

is a shame that that is the perspective. Because if you try to restructure a company successfully and maximise returns to all parties, the voluntary-administration process is fantastic to achieving that. An earlier intervention, when directors still have the resources available to fund something, always generates a better result." (Leslie)

The issue of insolvent trading as a driver of voluntary-administrator appointment and the role of appointment timing is examined further in the section below.

Appointment Timing and Preparation

The present research shows that once an Australian company gets into trouble, a key factor influencing the low rate of companies successfully rehabilitating under voluntary-administration is delay in the appointment.

> *"It's a function of when people decide to put their hand up and say, 'I'm in trouble.' So, you know, they can wait too long, and therefore the company that's there can't be restructured. It's just too highly geared, there's no equity in the business and you know it's been destroyed over a period of time." (Lee)*

> *"I don't think [the success rate] has got anything to do with the legislation and it's got everything to do with the directors not making the decision early enough. Directors generally have got their head in the sand and think things are going to*

turn around. If companies were put into VA a lot quicker by directors then I think the statistics would be a lot better.” (Adrian)

Participants were of the view that directors seeking professional advice following early signs of corporate distress or insolvency, increased the likelihood of the company enduring the voluntary-administration process and successfully restructuring. Early action was also able to align the stakeholders, capital and other requisite success factors.

“I am of the view that you don’t appoint a voluntary-administrator or embark on the voluntary-administration process unless there is some chance of the company emerging or some chance of the company being successfully restructured, and management have the mindset and the determination to follow that through. Because it is a difficult process and it is hard work. Turning a company around or getting a company through a voluntary-administration requires a lot of determination, a lot of courage as well as a balance sheet, and support from employees and from creditors. So there are a lot of different ingredients in place, or a lot of factors that need to be aligned in order for the process to work.” (Leslie)

The earlier involvement of practitioners also provides an opportunity for identification of those troubled companies that may benefit most from the voluntary-administration process, and then to lay the groundwork.

> *"I think that it really does come down to before you embark on an exercise like voluntary-administration, making sure there is an understanding of what the end game is and making sure you understand what is hoped to be achieved by all parties and making your own assessment. So if liquidation is the likely or desired outcome, rather than going through that whole exercise, which might be a completely unnecessary cost, [it] can be circumvented in its entirety by just starting the liquidation process." (Philip)*

The inadvertent impact from the growing prevalence of informal restructuring in the Australian market and changing perspectives of what corporate rehabilitation may look like also affects the issue of formal administration appointment timing.

> *"There is probably successful restructuring going on all the time, but not in a formal sense - that is going on inside the companies in a way. So, I guess more of it is going on behind closed doors than perhaps we recognise in any formal statistics. So I don't think that it is the value of restructuring that is the question, it comes down to the practicality of it being too late once you are prepared to formally put the business in the hands of somebody else." (Sam)*

Practitioners identified this reluctance of directors to pursue the voluntary-administration process because of an underlying concern around the likely process outcome and the likelihood of liquidation.

"I think a major factor is that people see it as a terminal process, even though it is not designed to be a terminal process, and there is absolutely a stigma issue around that for directors. And therefore it's being done much too late. It's not plan B, C or D. It's kind of plan X, Y, Z in my view. I have seen a lot of situations where there is a reluctance to have a rigorous insolvency plan for fear that will become Plan A. You have to have it there and if Plan A isn't better than Plan B, then Plan B does become Plan A by definition." (Shannon)

Participants were of the view that instead, the early intervention by directors of troubled companies provided the opportunity for greater planning, and in turn greater likelihood of the successful rehabilitation of insolvent companies.

"Generally the directors tend to come and see you later rather than sooner, and really what has happened there is the position has deteriorated further. From an administration perspective, this has a significant impact on what resources are available and what stage the company is in, in which to embark on the process of trying to turn it around and trying to improve the position and trying to work with something. I don't think there is any insolvency practitioner, in Sydney or in the world, that wouldn't say that we could have done a better job had you arrived earlier or it would have been a different outcome if we had seen you earlier." (Leslie)

Participants also flagged the importance of developing a plan as to how the desired rehabilitation outcome would be achieved.

"I think that the key things to me are around earlier intervention and a strategy to turn things around. I think if you had those two elements covered off you would probably see more companies [that get] into the process getting out. I think a lot of companies go into VA thinking this is going to be the solution, but they actually don't have a financial solution. They need fresh capital, or a supportive banker or a supportive equity holder, and they go into the process without having that in place, and therefore it gets difficult pretty quickly. So working out a strategy for dealing with them prior to an appointment is critical." (Jamie)

One mechanism for improved planning of the voluntary-administration process and restructure outcomes for a distressed company is the concept of pre-packaging a rehabilitation or asset-sale plan, such as the UK pre-pack model. This was suggested to have the potential to provide greater certainty and quicker implementation of a solution to mitigate the rapid destruction of a company's underlying value and goodwill post-appointment. Participants were of the view, however, that the introduction of this type of prepack model in the Australian context would require mandating it in the insolvency legislation to facilitate its acceptance as a viable option.

"I think VAs are a fantastic tool in the sense that you can take control immediately, but the problem with VAs is that you just vaporise value pretty quickly, so you need to do something very, very quickly to preserve the value in that situation. That is where the value of pre-appointment work certainly comes

to the fore. I also think the increased use of pre-packs definitely would have a major impact, and I think heading more towards specifically authorising that type of thing to happen under the Act would be a good idea. I think that Australians generally are a bit more cynical and not trusting about pre-packs, so recognition of this path under the Act I think would create greater acceptance in circumstances where a pre-pack could work." (Adrian)

Participants indicated that the reason for the limited use of the pre-pack approach in Australia relative to other overseas jurisdictions was the s 420A provisions under the Corporations Act. Section 420A requires that in exercising a power of sale in respect of a corporation's property, reasonable care is taken to sell the property for not less than market value, or otherwise, the best price reasonably attainable in the circumstances. Participants were of the view that these provisions influenced administrators despite relating to a controller's duty of care.

"What I think is the reason that pre-packs are not often utilised is to do with the way [administrators] value the businesses and s 420A. I think there is a real fear by practitioners that pre-packs are a recipe to get sued, so they're difficult to do. The other thing is if you're looking at one where s 420A applies, well, how do you satisfy the requirements of 420A when you don't advertise and stuff like that, potentially and you just do a deal, so there's those issues. So even though a VA might say, 'I am a VA and I am not bound by 420A', it is just drilled right into us, the way the market works." (Lee)

Participants noted that whilst the use of pre-packs were prevalent in overseas jurisdictions such as the UK, with anecdotally improved levels of restructuring success, the theme of independence was identified as a key barrier to the administrator playing a meaningful role in any pre-appointment preparation. This raised the question of who should undertake the advisory work under a pre-pack scenario.

> *"I cannot speak for England and Wales jurisdictions but they seem to do it quite well. The problem is, when do we get involved as the insolvency practitioner? Is it the lawyers who present the deal to us? That is probably the better way to do it because the whole integrity of the VA process is to say I am independent of this, I've looked at this. So, to be honest, it does not really work that I get involved in it and help out that process." (Cameron)*

> *"It really is the main question of independence, in terms of an administrator being expected to act and be seen to be independent of the company. The extent of involvement pre-appointment can affect that. As well as having been called into a situation where insolvency is precarious, the question of how you get remunerated for that work is also a live issue, because extracting money from a company known to be insolvent is likely to be a voidable transaction. So the extent of advisory involvement by a future administrator really is limited in that pre-appointment context. Alternatively, it's just not going to ultimately be the same person who will give the pre-appointment advice and then take the appointment." (Taylor)*

Participants also sought to generalise the definition of a pre-pack in the Australian context to capture a broader concept of the value of planning leading into the voluntary-administration process for providing a more certain outcome. This was advocated to facilitate an improved ability to meet the tight statutory timeframes and improved proposal planning and documentation to realise stakeholder support for a predetermined deed of company arrangement or specific asset purchase.

> *"Pre-pack is a word that can be in some respects misused and misunderstood. But I think from my point of view that the best way in which you can turn your mind to pre-packing and successful pre-packing is looking at how much of a rescue regime you can plan ahead and document with a view to things being done more quickly, and more comprehensive documents being provided to creditors at or prior to the second meeting. So often there's not a lot of scope for that, because time simply doesn't permit things to be done quickly enough in advance. Or perhaps the variables are too uncertain to be able to plan it in advance. So in an appropriate administration a pre-pack certainly has a place and can work very effectively." (Alex)*

This section has indicated that a key reason for the low rate of successful rehabilitation of insolvent companies is appointment timing. The findings showed that directors' reluctance to embrace the voluntary-administration process earlier was due to a perception of the framework as a terminal path to liquidation. Participants identified the need for early-stage recognition of corporate distress and timely action to develop a plan for rehabilitation. In that regard, participants also sought consideration of the potential

benefits of a pre-packaged approach to insolvency, as a mechanism to mitigate the rapid destruction of a company's underlying value post-appointment. There was recognition, however, that for a UK-style pre-pack regime to be successful in an Australian context, there was a need for legislative endorsement of the process, given the issues of independence, influence of the s 420A provisions and the corporate regulatory environment.

Formal vs Informal Restructuring

Participants reported that there has been an emerging trend for distressed companies to seek to rehabilitate using informal mechanisms.

> *"Increasingly, the restructuring of the main assets and main business are dealt with at least outside of formal appointment, outside of administration or receivership…. It's only if that restructure itself doesn't work out that you might end up down the track of having a formal sort of mop-up." (Evan)*

Participants mentioned concerns over the value-destruction of the distressed company. They favoured an informal rehabilitation approach, particularly if the distressed company had not yet reached the point of insolvency, and particularly in the larger corporate space.

> *"Look, I think the reason people often [use informal rehabilitation] is because they feel there's going to be value destruction in a formal appointment. That's the reason why they look for some sort of informal arrangement. I mean there*

can be logic to it other than just the general proposition that, well, if you appoint an external administrator to something, well, then it's going to be worth less because the goodwill starts to evaporate. Therefore you go from effectively a multiple-type value of a business that could be there, to basically, well, what are the auction values of the business?" (Lee)

"So I see VA as being a relatively successful restructuring tool only to be used as a last card. Obviously if you can do it informally and avoid using it, do that first, particularly up the bigger end of the scale. Having informal processes to try and help businesses restructure I think is the way to go, because you get a much better outcome. Whereas once you make a formal appointment, I mean you can turn it this way or turn it that way but you destroy value and you destroy goodwill and those sorts of things. So I think there should be more emphasis placed on informal restructuring before companies are trading whilst insolvent." (Dale)

Participants identified the reputational and brand issues that formal appointments raise as a key driver of enterprise-value destruction in voluntary-administration.

"Well the big challenge with a formal process, I think, is the reputational issue and the perception of it being a distressed seller of assets. Formal insolvency brings with it the real risk of value destruction. Brand is also obviously a key issue, and the appointment of a VA can have a real effect, actually a huge effect on particular companies." (Alex)

Participants pointed out that informal restructuring can provide a distressed company with the opportunity to pursue rehabilitation without the spotlight of corporate failure necessarily hanging over its head.

> *"The key advantages of informal restructuring [are] that it does give a relatively out of the spotlight opportunity to work through issues, so certainly your ability to control what gets out – within limitations. And I think we've all got accustomed to the idea that some information is likely to be made more broadly available, and therefore people tend to become more careful of what they say and when they say it and in what forum." (Jamie)*

Participants took a very broad view of what forms an informal restructuring process could take.

> *"When I talk about an informal work-out I am talking about collaboration between a distressed company (and distress can be from a number of sources), [and] its stakeholders, typically lenders (however, other stakeholders can come into play), with the objective of keeping that company out of a formal administration. A nice, consensual arrangement that achieves a solution to the distress, so that covers a vast range of possibilities to avoid the formal insolvency regime." (Dale)*

Discussion around the benefits of informal restructuring also focused on the ability to bring creativity to the restructuring process, particularly with the growth in advisory services provided by some of the traditional insolvency firms.

> *"This time around I think there has been a trend away from formal appointments, and on both sides of the divide. The retention of professional advisers, be they insolvency practitioners, insolvency accountants or turnaround professionals, for want of a better word, to try and implement more creative strategies without a formal appointment, knowing that if a formal appointment is effected it's likely to go down a certain path. That path is going to have some benefits and some downside, and as a means of strategically avoiding the downside, often a strategy can be tailored to deal with the problem without the need for a formal appointment." (Sam)*

Reference to this trend towards informal restructuring from both the debtor and creditor perspectives reflects the increasing tendency for secured creditors to provide opportunities for informal restructure, before pursuing a formal appointment.

> *"The reality is, people are rehabilitating entities without going through an insolvency process, particularly at the larger end of the scale. That's a function of banks being more pragmatic and realistic and not just hitting the appoint button. It's interesting too, it reflects on…well, okay, why are people doing that? They think it's a better option than going through a VA, including the cost of the process." (Philip)*

Often this informal process would be supported by an insolvency practitioner acting as an independent accountant who monitors the process on behalf of the secured creditor.

> *"I think banks sort of look at it and sort of think, 'Well, okay, would it be better to put this through in an informal way?' But often you will have an insolvency practitioner who is reporting to the syndicate of banks, and he'll be looking at, well, okay, how is this going, are we getting the right numbers, does it make sense, has something else happened that causes us to change our mind. That type of thing." (Lee)*

Participants identified that the criticality of time presented a conflicting benefit between formal versus informal insolvency, with the former having an ability to immediately bring focus to the criticality of insolvency and the latter avoiding the procedural obligations of an administration.

> *"I think there are situations where insolvency is a fantastic tool to focus everybody's mind and actually get a result done, but on the flipside the risk around proper conduct of a transaction is very much being focused on the individuals that have been appointed. Discharging some of those [statutory] obligations takes time, it's just not very easy to make that go away without a proper series of steps." (Alex)*

The risk of an informal process being too slow was linked to the threat of further value

destruction, particularly if directors became reluctant to abandon a process that had been heavily invested in and to cede control of the process to an administrator:

> *"One of the risks around informal restructuring is that everyone spends so much time and resources on it that they don't want to see it fail, but actually there can be a lot of value-loss creep with that, which actually makes it line ball, perhaps even worse than the insolvency scenario. But because you have come so far down the road, the mentality becomes, 'It would be nice to finish it and not have to put it into voluntary-administration.' Also, I think that goes with a preference for control, certainly on behalf of certain people, the idea that you put it into the hands of somebody who has these statutory obligations, like a voluntary-administrator, when you have got directors and hedge funds who like to control their own destiny." (Shannon)*

In addition to perceived benefits of informal restructuring, a number of participants flagged concern about the trend towards companies pursuing an informal restructuring process because of the absence of protections offered under a formal process.

> *"I think it's dangerous. I think the advantage of a VA as a restructuring tool is that you have various protections, such as the various moratoriums. And I think that the VA is the perfect way to restructure, as it gives you that status quo-type situation, perhaps with the stand-out exception of* ipso facto *clauses. For instance, with landlords, if you don't pay in an informal restructuring you would likely trigger a default under your lease. Whereas in a VA, they obviously can't*

> *do anything during the moratorium period…it's an event of default, but they can't repossess it because of the legislation." (Adrian)*

Instead, a number of participants advocated that a well-planned and strategic formal approach to restructuring and rehabilitation planning was likely to produce the best outcome for a distressed company approaching insolvency.

> *"I would argue that [voluntary-administration], used properly and planned properly, absolutely should be part of a restructure process. I would differentiate that from unplanned insolvency and kind of free-fall insolvency, but sometimes the quickest and the best way through a work-out might be using some form of insolvency, albeit it might be [in] a limited form. Because sometimes you get better and more efficient use of the existing contractual arrangements, rights and documents through the insolvency regime." (Shannon)*

> *"So, reaching a point of restructure or the desire to restructure generally is a collaborative approach with directors or with management, and often it's a matter of organisation. They're basically saying, 'Okay we need to prioritise the triage of issues with how we are going to trade. Then with the very, very short-term issues, are there any areas here where we can free up some cash immediately?' So working capital management and control. And the next issue is, 'Now can we start negotiating with creditors and suppliers and see what we can work out?' Now from my perspective, the voluntary-administration process is best placed to deliver this." (Leslie)*

Whilst participants acknowledged the insolvent trading regime as a key motivator to formally appoint, a more sophisticated approach to this legislation has facilitated the increasing prevalence of informal restructuring. This has been assisted by the careful monitoring of the insolvent-trading risk through improved legal advice to directors and specific framing of advice to navigate around this risk in pursuing restructure.

> *"I mean, the insolvent trading regime often drives boards to an administration rather than some other form of achieving the restructuring. I think the Australian lawyers who practice in this space have got better at that, rather than the historically quite narrow advice to directors around what they needed to do in certain circumstances. As lawyers have got better at framing that advice and helping everyone work through the practicalities of structuring so they do to not trip up the insolvent trading regime, that enables them to continue to explore restructuring. So I think that the legal framework has been more carefully applied by the practising lawyers around, to enable people to achieve informal restructurings, but it remains a highly pertinent issue for the company's directors." (Dale)*

Participants stated that irrespective of whether a formal or informal restructuring mechanism was pursued, ultimately the successful turnaround was contingent on the company exhibiting the necessary characteristics to successfully emerge.

> *"I think the other things are that whether it's a turnaround that's within the VA legislation or outside of it on an informal basis, you still need the three or four key elements of a successful turnaround. That is, generally you need a management team, you need supportive financiers, supportive equity and you need an underlying business that has a future." (John)*

The findings in this section have shown an emerging trend towards informal restructure, particularly in the larger corporate space and as a result of improved insolvent-trading advice provided by lawyers. The trend has been driven by concerns in formal insolvency over the risk of enterprise-value destruction, reputational impact and brand damage. Participants also identified the ability to creatively achieve outcomes, particularly with available turnaround advisory and without the constraints of procedural obligations under a voluntary-administration. It became apparent, however, that a challenge to informal insolvency was focusing people's minds on the criticality of insolvency and the risk of people becoming caught up in a process they were reluctant to abandon.

Insolvent Trading

Participants reported that the s 588G insolvent-trading provisions under the Corporations Act operated as a real deterrent to company directors trading whilst insolvent due to the imposition of personal liability. This obligation on directors operating in a distressed environment played an important role in bringing about the appointment of a voluntary-administrator.

"So [the insolvent trading provision] is very real and it is a very real deterrent. It is a good way to focus people's minds on the need to appoint a voluntary-administrator, and it's a shame that that's required, as opposed to the viewpoint of directors thinking, 'I can't pay creditors now, I'm in a position of robbing Peter to pay Paul, and I'm paying this creditor in advance of that creditor etc. This situation is untenable, I need to appoint an administrator and restructure the company's affairs.'" (Chris)

"It has made directors conscious of the need to avail themselves of voluntary-administration, and more reluctant to try to continue and do deals to salvage a company that's doing poorly. If anything, the insolvent-trading liability has in my experience resulted in a great incentive to directors to make appointments of administrators in circumstances where they should." (Julian)

Whether a company was public or private was reported as a significant differentiator between how much of a deterrent the insolvent-trading legislation could be, with public companies being more affected by this legislation because of the separation between the company's directors and shareholders.

"I think there is a real difference between the public-company market and the private-company market in relation to the way insolvent trading works or doesn't work in relation to directors and their behaviour. Where you have got in, public companies, quite a bit of separation between the owners and

shareholders and the people who are directors, the latter generally holding a fairly small shareholding in the company itself. So, they will be inclined to act generally in what's in their own interests, which is not necessarily aligned with the company once it starts to get into genuine insolvency. Whereas in private companies, the directors are pretty much all in. Often it is all of their assets, their personal assets, their personal guarantees - they are already personally liable for a lot of the debt. So they will often not be deterred by the personal liability proposition…they have got to keep on going." (Taylor)

Participants questioned the value of the insolvent-trading provisions beyond acting as a deterrent, given the small number of prosecutions of directors actually successfully undertaken from a regulatory-enforcement perspective.

"Now, about the insolvent trading rules, though, and what the danger of that is. The danger is not significant, and the reason why depends on the circumstances. The test for insolvency, and the test for whether a company is insolvent, falls down to whether it's able to pay its debts as and when they fall due. So one of the first things that you do in your investigation is to work out a date of insolvency and formulate a rationale for that. From then on, it is trading whilst insolvent. Then you come to [a] director's personal liability for insolvent trading and that's where it becomes a bit more grey, and there are other defences that can be raised which can muddy the waters. So it becomes quite a subjective test. So for that reason there have been few actual successful insolvent-trading actions in Australia." (Leslie)

A majority of participants were of the view that this incongruence between the legislation's "bark and bite" presented an effective balance to assist directors to achieve an appropriate level of corporate fiduciary responsibility.

> *"Despite all of the risk and angst that is created in the minds of directors about their potential exposure to insolvent trading, you'll probably find that in the vast number of cases the risk doesn't equate to a serious exposure or claim being brought for whatever reason. So perhaps it's fair to say that we've probably got the current balance about right in that professional directors are certainly aware of the need to act proactively, but there doesn't seem to be a chronic problem at the moment whereby risk is so great that it's dissuading people from accepting and continuing appointments as company directors." (Alex)*

However, a number of participants argued that the rigid provisions of the s 588 legislation presented directors with a dangerous distraction and reputational risk, which inhibited their flexibility to pursue bona fide restructure of a distressed company in pursuit of the best interests of stakeholders.

> *"So you get a lot of board focus on their personal positions, forever distracted and concerned by the potential to be held personally liable for insolvent trading rather than the focus [being] where it should be - on fixing the company's problems - which is potentially incredibly distracting. This creates a reputation issue as well, particularly if you are dealing with high-profile companies with*

> *high-profile directors. They might not want to stick around for reputational reasons, and they have got better opportunities elsewhere. Whereas what you really want to do is to encourage and motivate the board to stick around, because they are the best-placed people to solve the problem". (Leslie)*

Indeed, some participants advocated that such flexibility in the insolvent-trading provisions had the potential to actually be beneficial for creditors, if directors were able to preserve the value of an insolvent company and to keep the business trading.

> *"There's an inherent conflict because the laws in Australia say, 'Well, director, you're going to get pinged for insolvent trading,' and they go, 'Well, I'm worried about myself first before I worry about the creditors.' And so in other jurisdictions I've worked in there is a lesser threshold…the director is willing to take on the risk to keep the company going effectively to act in the best interest of the creditors. So we need to really fix the laws, I think – to, say, loosen the straps a little bit and allow directors to…as long as you're acting in the best interests of the company's stakeholders then you should be fine. It's a little bit of a shame that we've got so focused on insolvent trading to the jeopardy of actually getting the best return for creditors, and that's what this game should be about." (Cameron)*

Whilst participants acknowledged that lawyers had become more sophisticated in providing insolvent-trading advice to directors of distressed companies, the letter of the law continued to present underlying risks to directors operating outside the formal

framework.

> *"We've had quite a bit of time now to become comfortable with the law, and we've now got the benefit of experience and higher sophistication that I think is permeating through the market, and also reflecting clients' expectations as to what lawyers ought to be delivering in that respect. I think by and large we have learned to navigate insolvent-trading risk better, but that doesn't diminish the fact that it is a very real risk for directors notwithstanding, and I certainly wouldn't want to be the director who has to bear that risk." (Chris)*

Participants also identified the potential for shadow-director risk under the legislation as an issue that needed to be addressed to ensure that advisors and financiers were not inhibited from supporting a distressed company endeavouring to undertake an informal restructure.

> *"Another downside that comes into the equation is the shadow-director risk, which is there for those who lend a hand, and there is this risk that lenders and professional advisors as well could be found to be, in effect, directors of the distressed company. If the company was insolvent or becomes insolvent, it can make a shadow director also liable for insolvent trading, and you don't need to be an individual to be a shadow director, as a company can be deemed to be a shadow director as well. So that can obviously affect banks as an institution. I think that's probably the big one, and I think that is one where you could get some changes made." (Sam)*

> *"I do think they need to look at the shadow-directorship issues. That would scare me if I was in the position of a corporate doctor. I don't think there is a lot of protection there for people who are in an advisory role outside a formal appointment. I think that the propensity of the law is to become more problematic, not less problematic, for those sort of people. So I think that getting properly qualified [people] in, without the protection of a formal appointment, is difficult in our regime and is probably one of the places to start." (Alex)*

Given the above, and following the Federal Government's decision not to proceed with their 2010 Safe Harbour reform initiatives, participants strongly advocated for the consideration of a chief restructuring officer to better facilitate informal work-out.

> *"Like, a while back Treasury put out a paper which was looking at Safe Harbour. They gave a few options as to how you might be able to effectively trade insolvently whilst you are restructuring. So that was by virtue of telling the market, or the other thing was not telling the market but having advisers there that helped you do what you needed to do. Now if the legislators are not willing to accept that, then I say bring in someone who is skilled in the area, like a chief restructuring officer or turnaround manager, who is a ticketed person and has the skills to bring to bear and pull the pin at the right time, not just because they're personally exposed for insolvent trading." (Lee)*

The findings supported the insolvent-trading provisions as an effective deterrent to directors - particularly of public companies - of trading whilst insolvent, and to provide a catalyst for formal appointment to occur. Whilst it was acknowledged that the level of successful prosecutions of company directors remained low, the s 588G provisions provided an important balance between deterrence and prosecution. However, concerns were raised surrounding the inflexibility of the provisions, in the context of bona fide informal restructuring and the potential for shadow-director liability to affect advisors and financiers seeking to assist the distressed company. There was consensus amongst participants that Safe Harbour-type provisions or similar protections warranted further consideration.

Chief Restructuring Officer (CRO)

Participants considered the concept of a chief restructuring officer with immunity from insolvent trading worthy of consideration by legislators to address a key barrier to further advisor engagement pre-appointment.

> *"One area that I would like to see in the legislation that would make it more effective is if there could be legislative change for a chief restructuring officer. But what would need to be changed in our laws to make that position tenable is the personal liability for insolvent trading. At the moment you can't really have somebody that's in charge of the company that's in the twilight zone heading into insolvency, unless you could free up that person from that personal liability for insolvent trading. Because what I think is an ideal outcome would be to have, say, certain accredited people to be able to go into corporations and have*

a shield from insolvent trading. That would be a good addendum, without upsetting too much of our current regime, that would be sensible and achievable." (Evan)

This would address the reluctance of third parties to get involved and advise distressed companies heading towards insolvency in an informal context because of potential shadow-director liabilities under s 588.

"The reason we don't do that is I am capital C conservative, I'm not going to put my firm in jeopardy by taking a CRO unless I can control that [shadow-director risk]. So it's with great risk that you go in there, at the moment [you are] exposed to insolvent-trading liability, you have no skin in the game except a professional fee and you can't necessarily move the board to a position…now you might retire quickly in that scenario but what use is that? There's got to be a way we can get to these companies quicker and use the skills that I and my guys have to change these companies." (Cameron)

Participants commented that for the Australian market, the provision in the Corporations Act for a chief restructuring officer would provide a valuable mechanism to better facilitate informal restructure and enable advisors to proactively manage and prioritise the rehabilitation process.

"I think a CRO absolutely would aid the informal restructuring process. To get someone who is inside the company rather than an IA [Independent Accountant]

who sits on the outside, someone with some degree of authority in terms of - they don't have to be the person who signs the cheque, like the administrator, but they have some degree of authority to work with the board and stakeholders - would absolutely increase the chance of that business remaining stable and getting out the back end. It enables the management team to focus on looking after their customers and managing…the business and get someone to the table who can manage all the stakeholder issues around the restructure." (Dale)

The scope of the CRO's power and position in such a scenario was considered critical for the role to be truly effective to bring about meaningful restructure, including involvement in decision-making at the board level, to both contribute and preserve value in distress.

"That's the problem that I've experienced with informal CROs in Asia. You can be injected but you can't push a board to do what it needs to do. So you tick the box in terms of you have the skills and the acumen to bring to bear in a distressed environment. You are predominantly brought in by the syndicate, who knows you and feels comfortable with you and will extend a standstill in the work-out phase; tick the box. Can you make any meaningful changes? This depends entirely on the culture of the board and whether it's willing to accept the feedback from the CRO. I think if we could find a way for there to be a position for a chief restructuring officer where you still keep the board in place, but the board must run its decision-making through and must be signed off by the CRO." (Cameron)

There was recognition of the value that such a CRO would contribute to providing leadership in an informal restructuring process, to giving direction and ongoing momentum to the rehabilitation of the distressed company.

> *"The other risk in informal restructuring is [that] the risk of just getting bogged down in a work-out and getting momentum can be an issue. Particularly where there are a lot of stakeholders, there often needs to be a real leadership role, which is often missing. You do see in these informal scenarios that the people who have the potential to take on these leadership roles are often the advisors, and that works best where the scope is very well thought through. To give the appropriate authority and mandate to that advisor to do what needs to be done…and what is the time horizon and appropriate incentive to make that happen, and a CRO is well placed for that role." (Sam)*

Participants suggested that the best person to undertake a CRO-type role to facilitate such immunity would be a registered or official liquidator, given that the insolvency environment in Australia differs from court-focused frameworks such as that in the US. It was acknowledged that such a change would be in favour of those participants who suggested it.

> *"Obviously this is vested interests speaking here. We would say that it would be ideally suited to those that currently practice as voluntary administrators, receivers and registered liquidators. So we would say it is more from the*

advisors' space, rather than from the legal space. Because it's almost like a chief operations officer/chief financial officer-style role in and around operations and finance, and in terms of legal questions [they] would then be empowered to obtain legal advice on particular issues. But I think it's more a position suited to the advisors' space rather than the legal space." (Jamie)

Whilst there was acknowledgement that the engagement of an insolvency practitioner as CRO would likely prevent that person from being subsequently appointed as a voluntary administrator, this was not seen as a disincentive for the creation of an independent CRO role.

"I would imagine it would have to be prohibited for the CRO's firm to be appointed the subsequent administrator or liquidator of the company. I think that could probably be the only way that would work commercially and legally from that perspective. Potentially it would mean there would be a separate market in terms of the practitioners who prefer to do the CRO-type role and may not do other types of work. Whereas the insolvency practices with larger structures would be available for more formal work, and the formal appointments and the administration itself. I think that is a commercial issue for the practitioners to work through." (Shannon)

A number of participants identified the importance under a CRO-type scenario if immunity from insolvent trading was given that caution was exercised as to the limit of that freedom and the need for regulatory oversight and accountability.

> *"I think it's a good concept. But having said that I think that sort of person would need to be licensed and there would need to be some form of regulatory monitoring of them, because it would be very easy for things to get very out of control. I think it must provide some level of comfort to people that, firstly, they've got the right training; and secondly, that they've got the experience; and thirdly, that someone's looking at them and saying, 'Yes, this is somebody who can be trusted with that sort of thing.' Because if they're in there to do something and they've got no, should I say, downside and minimum risk if it doesn't work, there's no deterrent to push the envelope is there?" (Julian)*

In that regard, any introduction of chief restructuring officer-type provisions would need to address these risks within the legislative framework to ensure that such downside issues were managed.

> *"Again the challenge is [that] there is a small number of what I would call grubby practitioners who might then take advantage of those sort of provisions and ruin it for all advisers who act with integrity, who actually want to restructure things properly. So the real part that I then struggle with is the potential for abuse by giving that person the immunity or protection from personal liability. The fact [is] that they can then continue to run a company further into trouble, rather than out of trouble, and do that with some sort of immunity, which ultimately results in a worse position for creditors." (Chris)*

The findings in this section provide support for the introduction of a chief restructuring officer to better facilitate informal rehabilitation, who is protected from the risks associated with insolvent trading. Participants identified such improved access to restructuring specialists outside of a formal framework as conducive to achieving timely assistance to distressed companies. The findings also suggested that the appointment of a chief restructuring officer would provide restructuring expertise at the board level, as well as leadership to drive the rehabilitation process and maintain traction. Given these responsibilities and immunity protection, participants recognised that such a position would need to be subject to appropriate qualifications and experience and strict regulatory oversight.

CONCLUSION

This chapter outlined the findings from semi-structured interviews with insolvency practitioners and lawyers. It presented findings in relation to the legislative aim of the Part 5.3A framework and creditor outcome focus in practice, including implications of the rehabilitation definition for interpretation of the success rate statistics. It then presented findings surrounding the issue of appointment timing once a company approaches insolvency, and the alternatives of formal and informal rehabilitation; these findings showed the insolvent-trading legislation as being a key determinant. The next chapter will discuss the findings from the perspective of legislative and practical barriers to restructuring, cultural considerations surrounding the operation of the framework and an ongoing transition towards a corporate-rescue culture.

CHAPTER 5: REHABILITATION BARRIERS AND THE PURSUIT OF A CORPORATE-RESCUE FRAMEWORK

INTRODUCTION

This chapter will expand on the findings from interviews with insolvency practitioners to describe the identified barriers in practice to effectively using the Part 5.3A voluntary-administration legislation. It will also examine the cultural context of the Australian insolvency framework and how to better facilitate corporate rescue as a matter of course.

BARRIERS TO THE SUCCESSFUL RESTRUCTURING OF AUSTRALIAN COMPANIES

This section will outline the barriers to successfully restructuring Australian companies. Study participants noted that while they were of the view that the Part 5.3A legislation was an effective framework for rehabilitating insolvent Australian companies, they felt that the legislation needed to continue evolving to ensure successful restructuring. Such objectives were contingent on identifying the barriers that affected rescue in practice and practitioners' understanding of the significance of such barriers and how they could be best addressed, including by drawing from frameworks overseas.

> *"Chapter 11, I mean everyone talks about Chapter 11 as the panacea. It's not the panacea, but there's some fantastic aspects of it". (Cameron)*

This section will first consider legislative barriers, then go on to discuss findings relating to practical barriers.

Legislative Barriers

The findings identified and discussed a number of key legislative barriers outlined in the literature, which participants identified as important in determining the ability of the Part 5.3A legislation to effectively facilitate the restructuring of insolvent Australian companies. These barriers included the absence of protection from *ipso facto* clauses, the conflict created by administrator liability, the influence of senior-lender priority and enforcement, the effectiveness of the legislation with regard to company size and the role of court intervention and direction within the framework.

Ipso Facto Clauses

There was consensus amongst participants that the absence of a moratorium under the voluntary-administration legislation - preventing counterparties exercising *ipso facto* rights to terminate contracts upon a company entering formal insolvency - was a major barrier to restructuring under the regime.

> *"I think that* ipso facto *clauses are the single biggest issue. I'm sure there's not a practitioner in Australia that thinks that there aren't contracts that won't be terminated on insolvency. If you took that away I think we'd all be using the formal insolvency regime much more frequently to undertake these restructuring exercises." Shannon*

Ipso facto clauses were perceived as such a significant impediment to formal restructure that they were reported as a key motivation for the increase in informal arrangements and a key difference between major rehabilitation frameworks overseas.

> *"I think the big one is* ipso facto *clauses… I think that's the elephant in the room in the Australian legislation. This seems to be one of the key differences legislation-wise to some of the foreign jurisdictions such as the UK and US. I mean the whole purpose of the process is to preserve the business as a going concern if that is an option, and that would be lost if the key contracts are jeopardised. So the area is a big impediment to a lot of restructures I think. That's why often an informal arrangement would be agreed to." (John)*

Participants noted that the extent to which termination of contracts as a result of *ipso facto* clauses affected the likelihood of rehabilitation was a function of the nature of the underlying business and the reliance on major contracts that could be terminated.

> *"Different industries, it impacts on them differently, you know. In a number of industries it is completely critical, and the business disintegrates or puts parties in a position of strength very quickly once the trigger is pulled on the VA. Look, it depends on the particular business, but for a lot of businesses their value is in those rights that they have, to exercise whatever those rights are. You take that away and that business is leased plant and equipment, people, desks, chairs, whatever, so unless you've got that arrangement or that right to do whatever that is, it's worth nothing. So that's a real problem." (Jamie)*

Participants expressed frustration at the difficulty of bringing about change in this area of the legislation despite several reforms over the years to the insolvency legislative framework.

> *"Frustratingly, we're looking at a whole reform bill at the moment. There is an Exposure Draft out and again there's no reform on* ipso facto *clauses. Everybody keeps throwing it out, you need to look at that and there are other things they need to look at, but it always tends to be, 'Well this is the reform we're going to do'. I think there's certainly more that could have been done when they reviewed the Act in 2007 and* ipso facto *clauses were very hot on the agenda. So definitely those things are problems." (Lee)*

Participants identified that the challenges to legislative reform in this area primarily related to the issue of balancing the respective rights of contractual parties and policy considerations as to whose interests were to be protected.

> *"The counter to that argument is that all parties should have the right to determine their own destiny at that point in time. If the company fails should they be forced to continue to honour contacts? Now whose interests are you trying to protect, are you trying to protect the stakeholders of a failed business or those people with contractual relationships with that business? The legislation seems to protect the latter guys' interests and enable people to reconstruct their contractual relationships, terminate it, pull out of it or*

whatever, more so than the stakeholders. Look, I think it just comes back to a simple proposition and that is that you're interfering with people's rights. And if you're trying to reform the law there might be some fairly serious submissions being made by those parties against such changes." (Dale)

However participants felt that the extent of value destruction, which affected goodwill, and the value of the enterprise resulting from an absence of voluntary-administration protection in relation to *ipso facto* clauses, was contradictory to what the regime was seeking to achieve.

*[*Ipso facto *clauses] can go to effectively destroying a contracts-based business on day one, which goes against the intent of what voluntary-administration is all about." (Evan)*

This risk of value destruction also resulted in an immediate time pressure upon the appointment of an administrator to try to preserve those important contracts. In that regard, practitioners felt that a moratorium period would provide additional time for a company to communicate their restructure plan and reassure key counterparties.

*"*Ipso facto *clauses are a big problem because they can make the entire process unworkable, so you appoint an administrator and then* ipso facto *clauses are exercised by counterparties and they all blow up. What generally happens is that basically you have to get on your skates and get out there and speak to everybody as quickly as possible, and reassure them the company's going to*

> *continue to trade. Those can be very difficult conversations. I think if Part 5.3A gave a moratorium in respect of* ipso facto *clauses, I think we would be in a better place to try and rehabilitate and use the time effectively." (Leslie)*

Participants viewed *ipso facto* termination clauses as in the same class of issues that arise under a landlords lease; effectively as a sub-set of that same issue requiring protection during the restructuring process.

> *"So if there was protection from* ipso facto *clauses similar to the existing protection from owners of third-party property already in place. For instance, a moratorium period for* ipso facto *clauses I think would not significantly interfere with the rights of counterparties in any way differently to the way it currently interferes with the rights of landlords or other third-party property holders." (Adrian)*

The introduction of a moratorium would thereby consist of the rights of counterparties being preserved during the voluntary-administration period, with termination of any contracts temporarily prohibited.

> *"If they could, for example, not necessarily be expunged, but let's say delayed. I guess the way I think about it is the way landlords are treated in voluntary-administration. They are still the landlord, or leasehold interests (be it a landlord or equipment leasehold interest) - they are suspended during the*

period. They are still entitled to their rent payments of whatever under those agreements, but they can't take enforcement action during the period." (Evan)

This was the preferred protection mechanism from *ipso facto* clauses for a majority of participants. A minority, however advocated for greater protection from *ipso facto* clauses by prohibiting on a policy basis the termination of *ipso facto* clauses altogether, both during and after the external administration process, subject to the company continuing to meet ongoing contractual obligations.

"Well, my view would be that so long as you are performing your obligations under the contract, whether they are in administration or not shouldn't make a difference. So I don't think it should even be restricted to a 30-day moratorium, as long as you continue to perform. Unless post-restructure you don't have the infrastructure or staff to perform your contractual obligations, well then parties should have their contractual right for termination. However the appointment of an administrator in itself shouldn't trigger those rights and I don't see why you shouldn't be able to continue." (Julian)

However, most participants accepted that whilst moratoriums would provide an insolvent company with breathing space for a short timeframe, at the end of that moratorium the counterparty should not be prevented from terminating the contract.

"But at the end of the voluntary-administration period you still need to reach an agreement or to strike a deal or accommodation with them, if you are going to

proceed beyond the voluntary-administration period. Because the reality is, as is currently the case with landlords, if the landlord says, 'Look, I'm sorry we're not going to continue on with this, we've made up our mind, done and dusted' – well, there's nothing you can do. You don't have a sale of the business, so it can dramatically affect the return to creditors, the return to employees, that sort of stuff." (Lee)

Participants recognised merit in the legislature limiting steps to interfere with freedom of contractual arrangements post-moratorium, given the need to sustain commercial relationships and the principle of freedom of contract between the parties.

"It is probably almost a greater policy consideration…you get into policy considerations about how do you weigh freedom of contract against…creditor interests in an insolvent estate. I think it would be a pretty bold legislature to start chipping away at these long-term contractual rights. Because that's the thing, it is open-ended, because if you say you have got to keep supplying this company, well, on what terms and for how long? There could be all sorts of valid commercial reasons why one party might terminate the thing when a VA intervenes." (Chris)

Participants felt this risk was mitigated once the distressed company was able to demonstrate a viable restructure plan to emerge from insolvency, due to the natural tendency for counterparty suppliers to want to continue to trade.

> *"You will get a key supplier and you need that key supplier. You know what, the supplier is usually pretty happy to keep selling their product. Unless you've had a great deal locked in, in which case they will re-trade you to market – but that rarely happens – they are all there. So if, post-restructure, the company is able to demonstrate it has a sustainable and viable business, whilst as a counterparty you won't be compelled onto the new business, the reality is people want to keep selling you their products. As long as you're going to pay them." (Philip)*

The fundamental challenge that participants identified in relation to *ipso facto* clauses was the ability for counterparties to the insolvent company to opportunistically terminate or take advantage of that ability to enhance their bargaining power under the contract. There was unanimous consensus amongst participants that greater protection from *ipso facto* clauses was needed to address a key barrier to the operation of the Part 5.3A legislation and facilitate increased use of the process and value preservation. Participants advocated for voluntary-administration moratorium protection to be extended to include *ipso facto* clauses, to provide time for a distressed company to prepare and communicate a rehabilitation plan to contracted counterparties. They recognised, however, that at the end of such a moratorium period, counterparties could not and should not be compelled to maintain ongoing relationships between the parties post-rehabilitation.

Administrator-Liability Conflict

This section will discuss the inherent conflict between administrators and their liability. Participants acknowledged that - particularly where the viability of the business was

marginal with borderline cashflow - the administrator's liability presented an underlying incentive to take the more cautious decision and close the business rather than trade on once an appointment occurs.

> *"The other issue is this administrator trading-risk exposure, where you've got administrators going into this business which loses money and needs funding. I am on the hook from day one for a lot of stuff - personally liable. Indemnified out of some assets, but I am not sure if they are worth anything. Forget it, I'm shutting it down." (Philip)*

> *"I mean the personal liability in itself is something we think about every day. So it must create that bias. Whether there is a better solution I don't know. But it certainly creates that bias. Of course, if the risk is greater then the likelihood of going forward is reduced accordingly, particularly if resources are limited and trading is unprofitable or marginal. We are not inclined to put ourselves in a position of risk unless we have got someone else covering [us]." (Jamie)*

This higher level of responsibility for administrators was considered warranted given the level of expertise expected of a practitioner and the need for conservatism to prevent unnecessary value destruction through the administration process.

> *"Yes, I think it puts a higher burden on the practitioner, but we are supposed experts in the field and therefore we should have a higher burden. I don't think that it's much more of a burden than the directors' burden in terms of insolvent*

trading. Given that the thing is in 5.3A, by definition it's insolvent, or likely to be insolvent. So as an expert you should know better. So if it's not there explicitly I think it's there by implication. In any event I don't believe it would be in anybody's interest to absolve us of that responsibility. Because I think you've still got to have that underlying conservatism for it to work properly." (Julian)

Participants felt that this conservatism was not, however, a necessary inhibitor to creativity and innovative thinking by administrators during the restructuring process.

"But at the end of the day if I'm personally liable, I just think you've just got to think differently about how you skin the cat, so it ends in the right result. But I also think it leads to, the conservatism leads to better, more creative thinking. Honestly I don't think we've shut down any good business that's just not performing. I would say it's not the administrator's liability to risk. Yes you've got to be creative to come up with the right solutions, but you've got to have the underlying conservatism so you can say yes on the balance of probabilities [that] this will work." (Taylor)

Participants highlighted the conflicting challenge for an administrator in working out whether to take the risk of trading on the business with a view to restructuring or realising a better creditor outcome.

"Look, there is definitely that tension. I guess that the classic one was [a previous Australian airline], where you got two senior practitioners. The first

set of practitioners saw too much risk and were moving to shut it down within the first week. Another senior practitioner that had a look at it and said 'Oh no, we would look to continue to trade it on.' What they had to do in stepping in was to obtain a relevant line of finance secured against the assets of the company such that they could protect themselves from their own insolvent-trading liability, or potential for that, in trading it on. But at least they looked forward to a solution." (Evan)

Interestingly, participants who worked with larger distressed companies tended to have a lower level of concern surrounding administrator-liability risk. This was attributable to the importance of the distressed business to its market and often to the support of the company's senior lenders.

"Look, I have no issue with liability. Frankly that's why I get paid what I get paid, because I'm personally liable. Administrator trading risk is often quoted as a serious factor, but…as VA I've been appointed to very large trading businesses and we have managed to get our heads around the issues and trade on the business. So is it a factor? Yes, it is. Is it a big factor for big substantial businesses with real positions to play in the market and the support of their syndicate of lenders? No, I don't think so." (Cameron)

Participants were also of the viewpoint that this tension with regard to administrator trading risk formed a healthy balance in facilitating ongoing trading with a view to restructure, whilst ensuring the management of value destruction for creditors.

"Administrator trading risk, well, yes that's a barrier; I think it's a healthy one. You are responsible for all debts incurred from the date of the appointment, which does tend to focus the mind of voluntary-administrators and you are watching every day - and in some cases several times a day - what the position is with respect to the equity that is available in the company and what debts you have incurred as administrator and making sure that headroom is still there and you are not making the position worse." (Leslie)

A challenge identified by participants was the inability for an administrator to plan for an appointment, particularly in the case of larger more complex insolvencies, which inhibited a coordinated and structured process to pursue a successful restructure.

"I think a big issue is some of the conflict legislation around your ability to pre-plan a lot of that stuff. I think that ideally you will have had an opportunity to get in beforehand and do a lot of pre-planning, because if it is a genuine restructure then it should be one of a number of options that are being considered in parallel. And one that you get to is maybe Plan C and the time that you try to implement Plan A being the sale process or something else, you should be planning for Plan C and you should have a well-worked-up plan. To me the constraint is[that] there is a lot around that whole independence piece in advance of an appointment… particularly for large matters, the appropriate pre-planning and engagement within the business so that you are completely ready to step in as administrator and the acceptance that you can have a very

clear plan to execute once you go into administration and for people to recognise that that's okay." (Shannon)

The challenge raised by participants was in the absence of planning, the very short period administrators have to really understand what they have got and the assets that are indemnifying them. They felt that this challenge had the potential to often focus administrators and staff too much on the day-to-day trading operations, which could actually be left to management, and too little on the restructure.

> *"If there was better pre-planning, then I think a lot of those issues go away because the potential administrator can educate themselves to a point where they can put in place appropriate controls without needing to sit there and eyeball every single creditor themselves. I actually think that that whole thing has gone too far in the Part 5.3A space. Yes, the administrator has liability and that is significant, but does that mean they need to have 500 staff doing the job of the executive team? I don't think that was ever the intent of the legislation. I think it has gone there because there isn't an opportunity to plan and prepare appropriately for the administration of a large entity or enterprise." (Dale)*

Participants expressed concern that changes to how the administrator-liability provisions operated, whilst likely to improve the potential to restructure and rescue more companies, could also have a negative impact on creditors and, in particular, suppliers.

"I think a lot of care needs to be taken around any changes of that liability, because the suppliers need to have some confidence that they're going to get paid, because they have already dumped a whole bunch of money. As a general rule the practitioners all look to do the right thing. But it's like anything: there are some cowboys out there who just try to take advantage of it. Look, from my personal point of view, if I didn't have the personal liability I might be less conservative about decisions to trade. But it does force you to balance both sides of the ledger." (Julian)

However, participants were also of the view that the combination of generational change and shifts in how administrators assessed a business and the restructuring process was changing the perceived risks associated with trading liability.

"I think maybe the way to look at it is a portfolio review of insolvency practitioners, and there's a mixed bag of those guys. In fact, even in the younger generation coming through there's a big changing of the guard happening now [who] have been exposed to different things than the older, grey-haired partners. So we'd be a lot more, I guess, sophisticated in our approach. The older guys tend to rely on their guts a lot when they're doing it. It's just hard to get insolvency practitioners that are a good combination of gut instinct and the skills to bring it together. So I can easily see that some practitioners would go, 'This is too hard', over analyse it, 'This is too hard for me to take on'. But you know IP's can smell a buck. We should be commercial men and women, so we

should be able to say, 'Right I can transform this business into a dollar, not least because I'm trying to get my fees'. So we're aligned there." (Jamie)

Participants flagged the need for administrators to be given the flexibility to continue to trade insolvent companies with a view to a successful restructure, whilst concurrently being held to a higher account from both a registration and regulatory viewpoint.

"There's some legislation that's just not aligned to allow us to trade…I mean if the VA is truly the flexible tool that it should be and you ticket people like me, we should be held to the absolute highest level of accountability, but you should have absolutely the best people to do the job. If you don't cut it, and if at some stage I don't cut it, I expect the regulator to step in there and say, 'Right you cannot do this job anymore', and to cut us out." (Cameron)

To facilitate such flexibility, participants identified the value of further interaction with the courts to seek directions to mitigate administrator-liability risk to achieve improved outcomes.

"I think that's an area where the courts may have some impact, and we've had a recent experience with that where we have gone to the court and said that there is a potential personal liability here – get us off the hook and we will play it differently to how we would have otherwise…and the court was happy with that. So in that particular case we were able to pursue the best outcome. I mean we

did that with effectively the consent of the stakeholder who was exposed. If you did not have that stakeholder's consent it might have been different.” (Jamie)

This section has shown the importance of administrator trading liability in seeking to balance the conflicting objectives of continuing to trade a distressed company during restructure and the protection of stakeholders from further deterioration in their position. By aligning the personal liability of practitioners with the decision to continue trading, the framework has been reported to encourage administrators to exercise their commercial judgement and expertise with greater creativity and innovation. However, there was consensus from participants on the need for improved planning mechanisms, particularly for larger, more complex restructures, to facilitate more efficient administrator trading.

Senior-lender Enforcement

This section will discuss enforcement by senior lenders and how practitioners thought the voluntary-administration regime has shaped the ways senior creditors interact with the restructuring process of distressed companies.

“These days there are a lot of insolvency practitioners on secondments into banks and closer working relationships, which at the end of the day has changed the way that banks deal with their recoveries. I've always had a theory that the driver for banks to adapt to a change in thinking was a result of the VA regime coming in. When I first started in insolvency, the catch cry was ‘your first loss is

> *your best loss', and so once there was a default an appointment was made. I think that banks have really looked at the VA regime and I think they've evolved with the process, and feel comfortable with the process and they see some savings in costs where they're not having to pay for receivers even though their rights are still being protected." (Adrian)*

Participants were of the view that particularly in the last few years, senior creditors have increasingly sought to work collaboratively with companies seeking to restructure under the voluntary-administration process.

> *"I think that the current balance is pretty good where it is, and I wouldn't have said that two or three years ago. Because I think the banks in particular and more sophisticated lenders are aware of the benefits of the VA process, and are (subject to a number of criteria) more than happy to leave a VA in control of substantial assets. I think they realise there can be better outcomes achieved and better cost control. However, it comes down to a lot of factors, such as the integrity of the practitioner, the nature of the assets, the strength of their security, the contractual obligations of the company." (Jamie)*

Indeed, participants recognised senior lenders' increasing willingness to provide flexibility in not only loan-repayment scheduling, but also the provision of standstill or forbearance agreements to provide breathing space to the company.

> *"Senior lenders in Australia are increasingly willing to enter into standstill or forbearance agreements, where under that arrangement lenders are agreeing to not do things they are entitled to do because of the situation that has arisen. This is usually for a short period, while a company does things that can lead to a long-term solution and while independent accountants are working and other exercises are being followed through. So it is a breathing space, to identify what the immediate problem is, to sculpt a short-term solution to that problem while the bigger piece of work is being done." (Shannon)*

Whilst senior lenders' reluctance to pursue rehabilitation via the Part 5.3A process was reportedly diminishing, the issue of a formal appointment, where the business was highly reliant on contracts that could be terminated, remained a key deterrent.

> *"We do hear lenders say, 'Well, actually you have a very real option here of appointing, and we don't think there's going to be huge value destruction because we think that it's pretty well known in the market already that this company has some difficulties.' So that's not of critical concern, but it's obviously an issue when…and certainly one which matters a lot, if you have contracts where suppliers and others are going to terminate contracts the second that VAs are appointed." (Sam)*

This general reluctance for senior creditors to inhibit restructure likely to benefit broader stakeholders was further facilitated through the retention and protection of their security-enforcement rights.

"But look, I don't think banks are necessarily a blocker to this sort of stuff, I think they are open to restructure. I think that the views in recent times from banks is that they prefer a company to move forward and solve its own problems - if that is via a voluntary-administration with a plan that is discussed with them, with a reputable firm of practitioners that financiers are comfortable with, and further that [the] administrator proactively delivers the 440B notice waiving the notice period, basically saying to them they can appoint at any time whilst seeing what the outcomes are there." (Evan)

Participants highlighted that the key to any restructure succeeding is the engagement of the senior lender in the process and ongoing communication, irrespective of the company's size.

"So at the big end of the market, the starting point is to go through the senior lenders anyway, so I don't think it's much of an issue. At the bottom end of the market, or the smaller companies, it depends on who the practitioner is as to whether or not the secured lender will get in there. As administrators, as long as we're open and honest and say this is what we're doing, this is what's being proposed…usually they will go along with it and monitor it." (Julian)

There was a view that this shift in senior lenders' approach was also influenced by a greater focus on their brand preservation and perception in the marketplace.

> *"The banks for a number of reasons would prefer to be one step back, because I guess one of the primary things that banks are managing [is] their brand names and their reputation in the market, and those brand names are worth billions and billions of dollars. They much prefer the perception of the boards doing their own restructure rather than the perception of a bank-imposed restructure. So as long as their security is being appropriately dealt with and the administrator is maximising their return on their security, and they've got some transparency and comfort around the administrator, my experience has been that they view voluntary-administration with an appropriate plan attached to it relatively favourably." (Cameron)*

Whilst participants acknowledged that there was theoretical scope within the existing Part 5.3A regime to introduce a moratorium on senior creditors enforcing their security, there was a strong view that in practice such a change would provide little value to the overall rehabilitation framework.

> *"I believe the balance that we have currently got is a good one. Whilst there is certainly scope for a stricter regime as against secured creditors, I think undue prejudice would be occasioned to secured creditors in making it stricter, and would have implications in the marketplace if securities weren't as readily enforceable as quickly and as easily as they presently are. I think banks are very open to listening, and if they think that it is the way to go they won't appoint over the top, they won't exercise that right to appoint a receiver. But I have to say that you have to get agreement from secured creditors in order to make a*

> *restructure happen anyway, which I think you get in practice. So do you need legislation for it? Probably not. It would not be my top pick for legislative change." (Adrian)*

In fact, a number of participants raised concerns that the introduction of a moratorium restricting enforcement rights of secured creditors may actually have an adverse impact on the Australian rehabilitation framework, by encouraging earlier enforcement of security.

> *"I think probably it would mean that we would go back to a scenario where once there was a default and the bank gets a whiff of an administration, they'll appoint before the administrator goes in. So you'll go back to the old regime [that] they've got to get in quick and circumvent the ability then for an administrator or a restructuring." (Ben)*

In fact, a number of participants suggested that achieving the support and sanction of the secured creditor was a key driver to not only achieving a successful restructure, but underpinning the credibility of a proposed plan.

> *"I think that any restructure is going to be driven by the secured creditors, and is going to require the secured creditors' cooperation, and it's going to be largely driven by the attitude of the secured creditor. But if the secured creditor hasn't appointed during the decision period, generally it is because the administrator has been able to convince the secured creditor that there is some*

> *sort of credible plan that is being put forward. There is some kind of outcome that is being worked towards. And I think that brings the secured creditor along the journey and, to a degree, keeps the administrator honest." (Leslie)*

Indeed, if the proposed restructuring plan was not going to be supported by the distressed company's secured creditors, it was likely to be doomed from the start, according to participants.

> *"There is no point, really, you are basically saying, 'Well, here I am, here is what I plan on doing. Does that work for you?' Because the reality is if it doesn't work for them, 'Oh, well, we don't like it, so we are appointing a receiver.' It does influence, there is no doubt. Even if a moratorium period sought to address this, I struggle to see a circumstance where you'd have a moratorium period with a really unhappy and disengaged secured creditor which could end happily, because at some point the moratorium period comes to an end." (Adrian)*

Participants noted that in practice they were seeing an increasing reluctance by banks to appoint receivers over the top of VAs, and an underlying focus on the preservation of going-concern value.

> *"I mean part of that goes to the attitude of secured lenders, and their willingness to appoint over the top is not something they enthusiastically do. Clearly, to achieve stability and maximise going-concern value you need the support of the*

> *lenders.* Prima facie*, it probably makes sense that you get that moratorium as well, but I don't think necessarily banks having that right means that going-concern value is undermined, because I don't see them appointing very often. So in practice…theoretically it should exist, but I don't see in practice banks acting against their own interests - that is, acting to undermine going-concern value. I don't see that." (Shannon)*

Participants indicated that the conflicting benefits for senior lenders of a receivership vis-à-vis the VA process were also shifting due to the greater alignment of creditor interests and no requirement to indemnify under the VA process; they noted that this mitigated the traditional need for greater process control.

> *"You look at most appointments and the banks are reticent to put in a receiver …you've got to put an indemnity in there. So why do they put a receiver in as opposed to just a VA? Because they want to control it and there's the potential that they could - even if they put in a VA, that VA will get replaced by somebody else, and all it takes, as you know, to get a VA replaced is to have a creditor body stacked against them. So you know as a VA I'm acting in the best interests of everybody; as a receiver I've only got one person to look after, or one entity, but most of the time they're aligned. But you know you can see the conflict there, but the banks are more aligned now and they're not making the appointments. They're happy to let them just pass through to administration." (Dale)*

Notwithstanding, participants were of the view that even in circumstances where the secured creditor did appoint a receiver, the likelihood of an outcome in the best interests of unsecured creditors and the continuation of the underlying business was not felt to be adversely affected.

> *"But at the end of the day if they don't think it can be restructured, or sometimes there can be issues with practitioners they're not comfortable with for various reasons, well, then, they're going to appoint over the top. So the bank will appoint a receiver and that gives the opportunity for the business to be sold. You might say, 'Well, okay, that's not really in the interests of unsecured [creditors], but at the end of the day it is in the sense that the business will move off, so it will go from someone who can't manage this business to someone that potentially can. The employees will keep their job and the business will keep going. So the receiver has gone in there, sold the business, then dealt with his secure position. And if there's surplus money involved, it can also facilitate a fairly significant distribution to the unsecured creditors." (Philip)*

One fundamental shift identified by participants at the large end of the restructuring market is banks becoming less reluctant to sell distressed debt to hedge funds and alternative debt traders.

> *"There was traditionally a real paranoia about hedge funds and vulture funds and all those sort of things, and banks really shied away from that as an exit alternative. Then a few years ago something clicked and the hedge funds started*

to be seen as a viable exit alternative. I don't know but I understand that it has been driven a bit by the cost of capital for having impaired loans on the book and that sort of stuff. Suddenly the cost of selling the debt for a discount seemed like a pretty good option." (Evan)

Participants also identified a greater market-capital flow with the growth in the Australian secondary debt market, facilitated by a growth in market participants and the increasing willingness of lenders to trade distressed debt and consider alternative exit scenarios.

> *"[Hedge funds and distressed debt traders] don't have the same things that banks do in terms of BASEL and other restrictions. But you know it's going to be a slow thing, like the secondary debt market in Australia has been there latently but it's probably really only had a real spur on in the last four years. So it's about senior lenders identifying the right solution, and I say the right solution in the market today is not necessarily receivership, it's 'let's have a look at this other capital'. Now it might be that you end up with a receivership, but let's really have a serious look at whether you can trade out and get it built into the psyche that it's an option. I mean in the US it happens all the time." (Leslie)*

Participants saw the emergence of the secondary debt market as an alternative tool in the debt-restructuring framework, with loan-to-own mechanisms providing the potential to efficiently redistribute capital.

"But longer term it has got to be part of the furniture, it has got to be part of the solution to the work-out. And those guys do think of the loan-to-own, and they will try and transform the business and they will have completely different mindsets to value. So is that a more efficient way to distribute capital into the economy, by getting these guys in? Maybe. They might be taking advantage of us but I don't know – there has got to be money in it for them - there has got to be money in it for everybody, otherwise there is no point." (Philip)

This increased willingness of senior creditors to "mark to market" their debt, has provided the opportunity for third parties to pursue alternative and non-conventional restructures, including debt-for-equity swaps and credit bidding of assets, which Australian banks have been reluctant to pursue.

"Where you have a big business obviously over-debted, where the debt is worth more than the business and a consensual deal is done, right. Why does that happen? Well, in part I think what helps that happen is that most of the trading banks sold their debt at a discount. In other words, they were willing to take a compromise that reflected value, rather than take a stand, if you like. The people who were buying the debt, they were buying because they wanted to buy the business. They wanted to avoid insolvency, but they wanted to end up owning the business. If the discussion with equity hadn't gone the right way, then they would have put it into an insolvency process – a VA – and probably credit bid it and owned the business." (Shannon)

Participants identified that the different viewpoint brought into play by these secondary debt traders created a dynamic shift; often through the use of the previously redundant Part 5.1 Scheme of Arrangement provisions to rehabilitate and avoid insolvency.

> *"The other really interesting dynamic is [that] not only are hedge funds coming in with a more flexible view on outcomes, the whole dynamic changes when they buy into the debt in a syndicate. You don't have a whole heap of tail enders there looking at how much of a write-off they are going to take, but rather you have got funds working bloody hard to optimise their outcome. They see it as maximising a return, and the energy and creativity that goes into that is very different to someone who is trying to mitigate a loss. It is a different mindset. You need to balance the interests of stakeholders who have some sort of say or consent right in the restructure – how much do you need to offer them to gather their support? It leads to some interesting dynamics, you seeing where you have got to get a scheme of arrangement across. You see mezzanine lenders who are under water and equity getting some sort of return out of the restructure, just to get their support." (Cameron)*

Participants also saw greater opportunities for mid-sized to large companies in distress to restructure following a senior-lender selldown in the secondary market, particularly as transparency around secondary debt pricing increases and schemes of arrangement costs start to decrease.

"What is interesting is that this is certainly not exclusively limited to the syndicate space, where it is more publicly recognised. There is the potential for a lot of debt-for-equity or quasi-equity-type structures to be put in place by a range of banks on a bilateral basis, and I think there are a range of views across lending institutions as to their appetite for that. But I think we have seen certain institutions do really very well around doing things out of being a little bit creative." (Sam)

Part of the rationale for the reluctance to date for this secondary debt market to filter down from the high-end institutional and syndicated debt space to the middle market, is the different perspectives and approach taken by work-out bankers dealing in this mid-cap portfolio.

"The problem is that whilst the institutional guys do think about it, and they say, 'Right, what's the cost of my capital in the bank, what can I get on the market, is it a good deal?' – problem is that that's not where it is in the mid-cap space in the work-out part of the banks. They're not thinking about these options. It seems that some of the bankers don't want to take a haircut. It's like a binary…I have got to do a receivership or I keep the file. You can do both, and it should just be a decision: do you want the client or not? If you want the client you should be trying to pass it back up to good side as quick as you can, and you should be trying to minimise the bank's losses on it. Now if that means that you do have to take a haircut of 20% and you can introduce new capital into the

> *structure, then I reckon that's a far better outcome than paying me to do a receivership and getting liquidation value on assets." (Philip)*

From the findings in this section, it became apparent that the attitude and engagement of senior lenders in relation to the rehabilitation of distressed companies has become increasingly supportive and accommodating. With security enforcement as a last resort, participants noted that senior lenders had become more comfortable with the VA process running its course, in pursuit of broader stakeholder outcomes. Participants saw minimal value in practice in the introduction of a moratorium on senior-creditor enforcement, and instead viewed lender support and engagement as critical to a sustainable rehabilitation outcome. This section also discussed the increasing senior-lender participation in the secondary distressed debt market, particularly in relation to larger companies and the re-emergence of the Scheme of Arrangement legislation to achieve alternative non-conventional outcomes.

Company Size

There was consensus amongst participants that for the majority of Australian companies, the Part 5.3A legislation was to an extent a scalable process that was able to accommodate a range of mainstream corporate applications.

> *"It is scalable. That is one of the reasons why I think that the process works well. On top of that, what makes it even more scalable is s 447A of the Act, which enables the court to make any orders it sees fit in relation to the*

administration or its process. So if you had a voluntary-administration where for whatever reason, because of the industry or because of the size of it, or because of the scale, you needed more time between the first and second meeting of creditors, you are able to go to the court and seek an order varying the timetable or getting an extension of the adjournment period. So you are able to flex the process." (Leslie)

Participants were of the view that in the mainstream there was also cost flexibility in trading under the 5.3A legislation, which worked well for a broad range of companies.

"The cost with a smaller company…a smaller company is easier to trace and to monitor your liability position and trading. So you may find for a company that has…the best books and records, you can have a straightforward spreadsheet and a receipt book and a bank statement, then it is relatively straightforward to monitor it and to trade it. And in that circumstance there may be only one employee required working with the company's staff, which means that the costs are brought right down. With larger, more complicated businesses, where you have a variety of moving parts, [that's] really where the resources really need to come in." (Julian)

However, participants held the view that the structure of the legislation had a bias towards facilitating restructure in the small-to-medium enterprise (SME) segment, rather than the larger corporate area where most individually significant restructures would likely occur.

> *"I think it has a bias towards SME companies. I don't think it often contemplates what's required for large companies, and frankly, your ability to rehabilitate is really only going to happen in a meaningful way at the larger end, in my view. Everything else is more or less either phoenixed or just closed up very quickly, and that absolutely comes to directors coming at it too late." (Shannon)*

Participants perceived greater inherent potential for larger businesses to restructure, given their position in their respective markets, the impact of failure and the consensus amongst stakeholders on the importance of these companies continuing to trade.

> *"I would come back to this concept of the size of the business, its relevance to its market and materiality of the business to its market and its customers. I think that's the thing that holds the business together. So if they have got those factors, there is a greater chance of achieving the restructure, whether it is through formal or informal means. Larger matters also tend to have greater lenders' support behind them to put it all together, and they know that is just what's got to happen." (Dale)*

Participants who primarily operated in this larger segment were of the view that the legislation's existing timeframes should be better matched to facilitate restructures of larger, more complex groups, or a mechanism provided to push the VA process more towards the larger end.

"So VAs I think are SME tools – I mean, for anything of size I've got to go to court and I've got to extend the convening period and then I've got to have this pointless meeting to start with where people are all pent up and angry and want to ask questions. But there's no benefit to the creditors except for a venting opportunity. It's just a long way to the second meeting of creditors. And yes, there should be court oversight, I get that and I agree with that. But it's just too tight a timetable." (Cameron)

"I think when you start to get some of the larger businesses, it doesn't work particularly well because of the timeframes, and there is an almost ongoing need to approach the court to extend the convening period. To have to make the application as a matter of practice just seems a little expensive and unnecessary in terms of time and energy and effort, particularly if you have got some prospect of genuinely restructuring something and are working through the options. It would be great to see the VA legislation further develop to better match its timeframes and requirements to larger companies in response to that. Because I think some of the timeframes are just absurd when you're dealing with larger, complex groups." (Lee)

The framework for large companies was also identified as requiring participants to undertake a multitude of concurrent activities, creating an inability to focus on the trade-on of the underlying business with a view to restructure or sale.

> *"If I'm trying to do a deal to get the business sold, then I'm going to be focused on that, and I've got some other team in my business that's preparing a report to creditors. Well, to be honest, I'd rather say 'Let's go and work out what we're dealing with here first on the sale of business, get that nutted out and then we can work out what to do.' But the time pressure is immense. It's not to say that we're scared of working hard, but what's the utility of a VA report where you say, 'Look, I've just looked at this for a month, I'm going to caveat the hell out of the thing, because how can I seriously look at insolvent trading after a month of investigations?' – during which time you are trying to run and trade on a business and sell it." (Cameron)*

Participants identified that this posed constraints for large companies looking to restructure under voluntary-administration, particularly where the debt to be restructured exceeded $100 million.

> *"So I think Part 5.3A is a pretty good tool, but a tool up to a limit and in size. Anything with debt over $100 million you'd probably say is starting to get to a stage that there [are] just too many other variables, or stakeholders that need to be sort of included in the work-out. I mean, the VA framework is a pretty dynamic tool but it's pretty blunt at the same time. So I think I see part 5.3A more as a sub-$100 million, if I can call it that, SME space." (Evan)*

This was contrasted to the challenges for very small businesses at the other end of the spectrum to recapitalise their balance sheet.

"As you go into smaller, SME-style businesses, unless there is an ability to tap into some equity pretty quickly to compromise creditors' claims, like to get an additional drawdown or mortgage on the family home and offer that to creditors – you know, the prospects of getting to a successful result in smaller SMEs is pretty poor. Particularly now that we are seeing less headroom in equity and family homes and the bank's LVR requirements are tightening up, that sort of ability to tap that market for equity is reduced. Whereas, as you get into bigger matters, I have seen the element of success increase dramatically." (Jamie)

Participants also expressed concerns that at the very small end of the market the costs to undertake a successful restructuring had the potential to be prohibitive under the legislation.

"As far as cost is concerned, even in a fairly small organisation the costs associated with a successful voluntary-administration are significant, and often disproportionate to what is trying to be achieved. In a large organisation, whilst costs are generally larger, they are still proportionate given the size of business you are trying to save. But in a smaller organisation it's certainly the case that costs can be oppressive and of themselves cripple the ability of the regime to reach a successful outcome. It is still generally seen as a terminal process, and where deeds of company arrangement are used, they are really used to effectively mop up the assets." (Alex)

The extent of costs incurred even for these small-end companies related to not only the marketing and documentation required for a sale or DOCA to be achieved, but also the compliance and investigation reporting. Participants questioned the extent to which value was added through this process.

> *"A lot of it's around ensuring you have gone to the broadest market you can if you're looking to sell the stuff and that has a cost in itself. Others, it can be around the documentation that's required to pull a DOCA together or to pull a sale together. And all of the stuff you have got to report. I don't have a problem with the issue about fully disclosing or fully investigating things, but I think that some of the stuff that's between ASIC, the IPA, and the Institute, and the various regulators and things that are required to be in the reports to do it, doesn't add any value. I know that when I speak to creditors about how much of the report they read and…all they read is when they are going to get their dividend. You cut the amount of costs, which means theoretically much more money is available for creditors and that can't be a bad thing." (Julian)*

Participants raised concerns that the VA legislation was one piece of legislation that was meant to fit all sizes, ranging from a family-controlled small business right through to potentially multi-national corporations, with suggestions for a transition to a split-framework model.

"I've never thought that a 'one size fits all' situation works. It's like a suit that you and I might wear, one size doesn't fit all. I think it's good to think about an alternative regime for larger corporates, where it starts to struggle in its current form, to facilitate large-scale restructurings – particularly if you are looking at businesses that need to be maintained in the national interest or infrastructure assets. Because I don't think it is easy to come up with a legislative framework that cuts the full scale of businesses. And so I think if we could then push VA further towards the smaller end, that we might see it used as a more effective restructuring tool over time." (Taylor)

However, participants recognised the challenges of a transition to a split-process framework that distinguished between small and large companies, and they emphasised the need for flexibility in access.

"Look, I think the challenge is always going to be coming up with an appropriate definition of large and small if you are going to have a split framework. I think the only way I could see that working is if there was a small and a large and quite a big overlap in the middle where you can pick and choose depending on the circumstances to work out which is more suitable. So I think you need some discretion and flexibility." (Shanon)

An alternate recommendation from participants was for the retention of the existing Part 5.3A framework, with the provision of additional guidance on the quantum of work required from practitioners for very small companies. This was advocated as giving the

ability to provide improved outcomes for the likelihood of rehabilitation and/or improved creditor returns.

> *"If you've got a company that turned over half a million bucks and it's got 150 or 200 thousand dollars in creditors, why am I required to write exactly the same report as a company with revenue well into the hundreds of millions of dollars? The actual requirements to write the reports are no different, so I think there could be some potential guidance, if you like, under the legislation and regulations and things like that about the amount of work that you should do." (Julian)*

The findings recognised that whilst the current VA framework operated well in process and cost scalability across a broad range of company sizes, improvements were needed at the very small and very large ends of the corporate spectrum to improve the framework's effectiveness. Two alternatives were suggested as potential enhancements to the existing "one size fits all" approach, including a split-framework model designed to accommodate companies by size or the provision of additional guidance provisions within the existing framework to provide greater process efficiency. With regard to the latter proposal, participants saw an opportunity to shift the voluntary-administration framework to address the somewhat cumbersome and challenging aspects of the existing process, to become more user-friendly for large corporations. In conjunction with these amendments, participants suggested the development of policy guidelines to support scaling back the scope of work for small companies to provide enhanced scalability, and thus contain costs.

Court Power and Direction

The findings in this section recognise the potential in specific circumstances for the improved use of provisions under the legislation to engage the courts as a mechanism to achieve successful restructuring. Participants identified mechanisms to better engage with and seek direction from the courts in Australia, potentially under the s 447A general provisions contained in the legislation, to provide flexibility and meet company-specific objectives under the Part 5.3A process. This included greater latitude to seek court direction and facilitate outcomes where individuals or groups of stakeholders were inhibiting a restructure outcome that was in the interests of broader stakeholders or the rescue of a company.

> *"I note that under our legislation there are some general provisions that allow you to seek direction of the court…. If you can put a cogent argument together, you can achieve a hell of a lot just through those general provisions under the VA regime – and in particular, to get the judge to make an order. So the reason why things such as the cram-down are attractive is to prevent the potential to have a relatively small stakeholder hold a lot of other stakeholders with a materially bigger stake in the problem, holding them to ransom. Look, I think in some respects we can deal with that in our current regime, if we can show a particular class of creditors to be unreasonable." (Evan)*

Particularly in relation to key suppliers, participants identified scope for the use of the court to provide direction to the voluntary-administration process and to progress a restructure proposal.

> *"In terms of suppliers, if they're holding out for a higher return and being unreasonable about it, as long as we can show that their return under the proposal is superior to what their return would be under not having that proposal (i.e. liquidation), they may be forced along by virtue of court order to fall in line with everybody else. I mean the VA regime does talk to essential service suppliers, and so there is also an argument that if you have got a key supplier, you might be able to argue that for that particular business it is an essential service, as without that essential supplier there is no business." (Alex)*

Participants further flagged scope within the existing legislation to seek court direction on issues such as insolvent-trading risk for advisors, which in specific scenarios might resolve some of the existing barriers relating to shadow-director risk under the current legislation.

> *"It's very, very common for an insolvency practitioner to work with the company [and] provide the board with advice, and it's up to the board whether they take it or not. For the practitioners providing them with that advice, I believe the issues surrounding shadow-director risk may be potentially mitigated under Section 1317S of the Corporations Act, which in my view does provide prospective relief. So I don't see why you couldn't make an application to the*

court and say, 'This is my CV, [these are] my qualifications, this is what I'm trying to achieve and this is my plan. I ought fairly to be excused from liability for insolvent trading because one day this could go wrong but all I'm trying to do is do my best,' and see if the court will make an order excusing you from personal liability for insolvent trading." (Leslie)

In such matters as applying for extensions to moratorium periods under the Part 5.3A, participants noted that Australian courts were generally forthcoming to assist administrators in helping larger companies work within these timeframes.

"You get a moratorium, you get a period of time that the courts have been very good around acknowledging too. For the sake of the legislation there are some time periods, but if the shoe does not fit, the courts have been very good at saying for big complicated business that we will give you more time. Even recently, on [a large services-company matter], the administrators got an extension on the period that they don't have to pay rent. Which is a pretty big call, right, when you are occupying their property and you don't have to pay them rent. So the courts have been really good". (Philip)

Particularly with regard to more complicated or creative restructure-proposal scenarios, participants felt that rehabilitation was potentially more achievable if administrators sought greater interaction and direction from the courts.

"For example, I think in the secondary debt market, the loan-to-own strategists if you like, are very, very uncomfortable with the idea that the administrator has control, having regard to all of the obligations that they have more broadly. I think they would be more comfortable with a process that saw them running off to court more, but without that vesting in an individual. Because the Part 5.3A legislation essentially delegates a whole lot of quasi-judicial decision-making to the administrator, and with that comes a whole lot of responsibility…what you tend to find is [that] an administrator will always take a conservative approach such that they are not criticised. That does not work very well for the hedge funds, who are looking to be a bit cutting-edge and clever about how they go about doing something, so the two don't meet very neatly at the middle." (Shannon)

In fact, participants saw greater potential for the voluntary-administration process to embrace increased court involvement where administrators had concerns in discharging their delegated responsibilities, to facilitate corporate-rescue outcomes.

"Control is wrested out of the hands of directors and the executive, and placed in the hands of one person, and it's all well and good to say, 'Well, the administrator should be more commercial.' But there is an awful lot of delegated responsibility that comes with that role, so I think it is unrealistic to expect [that] an administrator can always be as nimble as some would like them to be. Although we have some examples of some very effective use of the court system by the administrators so they can get on with doing their job. I think that

is actually how it is meant to work, but we haven't seen enough of that." (Taylor)

Instead, participants had the view that the Australian judiciary had a responsibility to provide greater assistance and direction in applying the legislation and make the judges more administrator-friendly to facilitate corporate restructure.

"Whilst the ability to make an application exists, a lot of times they go, 'Well, this is really a matter for you to decide,' whereas if there's some ability for a court, whether it's a specialist court or not, to review these things and go, 'On balance, you've satisfied these requirements and therefore we think it's going to be okay.' Without going the whole hog to Chapter 11, give administrators the ability to apply to the court for greater directions to facilitate improved non-conventional outcomes for stakeholders. The judiciary should be giving the insolvency practitioners – who are, at the end of the day, officers of the court – that is, official or registered liquidators, more assistance when they make applications for directions." (Adrian)

However, participants reported that whilst there should be more court involvement and direction, there should be a limit to this involvement, which should fall short of compelling contracted parties into ongoing relationships against their will.

"The fundamental problem for restructuring is [that] the legislation stops short of compelling ongoing commercial relationships, and I think that in a way that

is necessary. It is the same concept in law that we have that courts are reluctant to make specific performance orders for Mareva-type injunctions that compel people to go forward together. The law is reluctant to do that and so is the legislature – because they are commercial rather than legal relationships that you are binding people into, and you can't fundamentally restrain people from enforcing breach-of-contract rights, because freedom of contract underpins our economy." (Chris)

Participants also questioned the potential for court involvement to provide a mechanism for the deliberation of social considerations and objectives in an administration outcome.

"I certainly think that the courts have made it pretty clear they don't want to make commercial decisions. Whether they will make social decisions, I think they are probably more likely to do that. But I think that it has to head that way…it can't be all creditor-focused, as the outcomes aren't great. The outcomes are very short-term focused and not long-term." (Jamie)

More broadly, the view of participants was that a fundamental problem with a transition to a court-driven framework (such as the US Chapter 11) for a reconsideration of Part 5.3A was the absence of a developed judiciary in Australia in this area, and the frameworks likely focus on very large companies due to cost.

"I am not hugely in favour of completely chucking out our legislation and going for the US model, and one of the reasons I say that is it is very court facing… and there is some benefit doing that. But I don't think our courts are geared towards that. We don't have the expertise in the judicial system to get us to that place. Chapter 11 is not some magic, simple, easy, cost-free process, where the directors just keep going. There is court involvement, which the VA doesn't have, and that has cost. It is very much geared to the very large end of town in the US, and I would query exactly how many of those very, very large-end matters we would have in this country, [and] that we may find ourselves at risk of never using it." (John)

Participants felt that any move to a more Chapter 11-type mechanism for very large-scale corporate collapses would be better facilitated by amendments to the scheme of arrangement legislation for a process likely to have limited application in practice.

"Schemes of arrangement are to some extent already in that territory, because they are hugely expensive, court-driven processes. I think if we are only talking the restructuring of the very, very large end of town, it could be that we need something like the scheme of arrangement regime for insolvent companies, to effect a restructuring in that environment. I think if you were going to do that, you would just tinker with the scheme provisions and have greater latitude around the percentage and value that have to approve, and maybe leave it up to the judge to decide on balance. For example, you would get to a Chapter 11 system pretty quickly if you just changed those, I think you are pretty close if you

took out those very, very firm class requirements. So I think there are probably better ways of getting there, rather than just re-writing the Part 5.3A legislation." (Shannon)

The above findings identified the scope for using existing provisions under the Corporations Act to seek greater court involvement and direction where required. In particular, participants recognised that the scope of delegated responsibilities placed on administrators to facilitate restructure had the potential to benefit from greater court direction in need, particularly for restructure outcomes that are more complex or commercially challenging in nature. Whilst participants acknowledged that the design of the VA procedure sought to minimise court involvement as a matter of course, scope was identified under these broader Corporations Act provisions to facilitate restructure outcomes, without the need to import wholesale change into the framework.

This section has shown the impact of a number of legislative barriers to the effective operation of the Part 5.3A framework. Primary amongst these has been the lack of moratorium protection against the operation of *ipso facto* clauses and the corresponding value destruction that can occur upon appointment of a VA. This section also explored the role of administrator trading risk exposure in effectively balancing the conflicting interests in pursuit of restructure, and the need for improved mechanisms to facilitate pre-appointment planning. The findings then examined the legislative impact of senior-lender priority and enforcement, and identified increasing support and cooperation of senior lenders in seeking to achieve restructure outcomes, along with the emergence of the secondary debt market as an alternative form of outcome to distress. The section

then examined the role of company size and the "one size fits all" approach to rehabilitation under the Part 5.3A legislation, its impact on restructure effectiveness and potential alternatives for improvement to the framework. Finally, the section examined possible improved outcomes and flexibility in the VA process through the potential for administrators to seek court intervention and direction within the framework, and thus successfully achieve company-specific and bespoke company-restructuring outcomes.

Practical Barriers

This section will discuss findings relating to the practical barriers inhibiting the successful restructuring of insolvent companies outside of legislative considerations. These have been identified to primarily relate to i) the quality of directors, communication and trust; ii) the viability of the underlying business; iii) the company's books and records and reporting systems; iv) the impact of employee entitlements; and v) the role of the practitioner-in-possession model.

Quality of Directors, Communication and Trust

Participants flagged that the quality of directors was a key driver of whether a company would identify distress and signs of insolvency, and seek external advice in a timely manner.

> *"I think a lot of directors have a basic understanding of P&Ls, balance sheets and equity, but often don't understand insolvent trading and what that means, and what the signs of it might be and how you might start to react. Often a*

board of directors will accept the advice of the CFO, 'No, everything's fine,' whereas there are some warning signs that are showing up." (Lee)

Participants experienced a broad range in the quality of company directors and their understanding of the state of affairs in their company, particularly approaching insolvency.

"I mean there is a whole spectrum of variances. Some directors are in complete denial and have their heads in the sand and will simply just say, 'Everything is fine and everything seems to be okay, but I think I have a problem.' Others have bad information or simply don't have or don't understand the financial information, and don't understand the financial position. Then, others I have spoken to have been aware to four decimal places." (Leslie)

There was a significant negative impact on the likelihood of companies successfully restructuring if the directors had displayed poor conduct in their dealings with stakeholders.

"I have seen circumstances where directors have maliciously misled employees and creditors and deliberately not paid, for example, superannuation payments, but told employees they've been paid and given stories to trade creditors or what have you to string them along. Thinking that somewhere along the line there was going to be an exit for shareholders. And those circumstances – they do occur, and a restructure under those circumstances is very, very difficult. If

the creditors or the employees appear to be so against or non-supportive, in fact in some cases actually antagonistic towards the company, then I will actually say, 'Don't pursue the voluntary-administration process.'" (Jamie)

Honesty in directors' dealings with stakeholders was seen as a key catalyst for marginal restructuring plans being successfully implemented.

"Usually I find it's about the director or the company's relationship with the bunch of creditors: if they've been honest with them and upfront and haven't dragged them on and told them a whole lot of rubbish. It's about how honest they've been." (Julian)

The ability of directors to develop and maintain trust with stakeholders was also seen as a key factor for a successful work-out.

"There are a lot of stakeholders in these matters, and those include lenders, directors, shareholders and management. And one of the very important dynamics in these things is how much of the situation of distress that has arisen results in trust being lost between different stakeholders, particularly between lenders and management. And if you want to identify one factor that more often than not will be fatal to a successful work-out, it's probably the loss of trust between lenders and the people they are dealing with." (Shannon)

The director behaviour that presented the greatest barrier to restructuring was where equity had been eroded and directors had moved onto trading with the risk primarily being borne by creditors. This was particularly the case where directors had risked employee creditor funds without their consent or knowledge.

> *"Directors who have never paid PAYG, haven't paid super, effectively have borrowed from employees without their knowledge. Free funding from parties who hadn't agreed to lend them money. I am sure that if the business had done well, they wouldn't have paid them a cent more than what they were owed and kept all of the profits. I don't think that is right. I am pleased with the changes made around personal liability now extending to super as well as PAYG. In this certain context that is a good thing because we very regularly see that super does not get paid for a very long period of time and you have got people who are salary sacrificing super, so they have effectively not been paid their wages." (Philip)*

However, the general consensus amongst participants was that directors often did not intentionally mislead or display malice in their dealings with stakeholders leading up to insolvency.

> *"But generally on the whole most company directors are just trying to do the best they can. Some of these are people who have started the business themselves from scratch and built it up to a certain size, and due to circumstances outside their control they've ended up in a position where they*

might be insolvent. Others are people who have inherited companies or they are working on boards, and broadly, there is usually not malice involved in trying to get in that position." (Jamie)

Instead, participants viewed director's reluctance to recognise and acknowledge the state of the company's operations and level of distress as the inhibitor to seeking a timely solution.

"I think that part of the problem is just human nature of people not wanting to 'fess up to problems and people not wanting to lose control. I just think it's the way the directors have got the blinkers on. I call it 'they hear but they just don't listen'. People think they are better than they are and I think that's a fundamental problem. I don't think you will ever have a perfect system of intervention. I think that generally directors need to be made to do it [appoint an administrator], quite frankly." (Chris)

Participants were of the view that directors, in smaller companies particularly, were not adequately aware of their directors duties, which was a concern not only for directors but also broader stakeholders.

"The quality and experience varies dramatically, but the majority by volume in smaller companies are not adequately aware of their obligations as directors, or of the financial consequences of their actions. This could be improved by requiring a formal and measured level of competency for all persons seeking to

be appointed as company directors. This helps to protect the individuals as directors, and also those that they deal with in the business community. It may also result in a reluctance to enter into a business arrangement without proper consideration and preparation." (Alex)

Participants identified a greater need for education of directors around their responsibilities and duties as a director, to provide them with the tools needed as companies grew in size and complexity.

"So I think insolvency, and how you react to insolvency, is not well understood by directors, and I think there needs to be perhaps a better education of directors around insolvent trading and those sorts of things. Because at the end of the day there are no restrictions on becoming a director and opening up a one-dollar company and then growing that company to have revenue of a million or a hundred million dollars. There's no course that directors go through, there's no requirement to put a deposit down when you become a director, so in other words they are potentially responsible for all these creditors being incurred by a company, often with no capital base behind them whatsoever." (Lee)

Participants felt that training to provide a basic level of understanding around directors' obligations and duties was advocated as beneficial to directors of companies across the company-size spectrum.

"I tend to think that if people and the accounting advisers say that you need to set up a company, but before you set up a company you need to do a weekend course or something about directorships and their obligations – I'm not saying you need to go off and do a company secretaries and directors organisation-type course, but just something basic, even if ASIC ran it for example, a basic 'do's and don'ts' of being a company director – I think that would help people understand what their obligations are." (Adrian)

This was also perceived as an opportunity to focus directors' minds on the importance of seeking assistance and advice earlier, and to remove the stigma of failure often associated with seeking this type of help.

"So I think the only way we can improve that sort of corporate-rescue based culture is to provide an education for the directors that says, look, if you think your company is in trouble – to try to get them to get advisers to act for them sooner rather than later. There's got to be a way that if you get advice you make it sound like the directors are not a failure by getting that advice." (Chris)

This section has outlined the challenges associated with the failure of directors to identify and act on distress in a timely manner, which was often attributed to a lack of financial understanding by directors, shortcomings in reporting and an inadequate understanding of their broader obligations. There was consensus amongst participants of the importance of ongoing communication and trust between directors and stakeholders in seeking successful outcomes, particularly where the rationale for restructure was

marginal. Participants advocated for improved education requirements for company directors as key to addressing the impact of corporate failure and distress, and improving the likelihood of rehabilitation.

Viability of Business

In addition to the importance of communication and trust with key stakeholders, participants identified the importance of an underlying viable business.

> *"What are the key ingredients to a successful restructure? For me, they include good communication and trust. You need a plan that is worth working towards, a company that deserves to be saved and an ability to get on with it." (Sam)*

Participants stated that the potential for profitable and sustainable cash flow was essential under any rehabilitation regime.

> *"There will always be companies that have reached the point where neither the Part 5.3A regime nor anything else will be effective to save them. They are unsalvageable no matter what you do. But insofar as those companies in the middle, I suppose, who do have prospects of salvation, I think the regime is a good way in which there is a mechanism available to achieve that." (Alex)*

> *"Usually the reason the business does not rehabilitate is not a failure of the process, but that it does not make any money. If it's not a viable business, a VA*

can't fix it, a receivership can't fix it, a debtor in possession can't fix it. If a business loses money and keeps losing money, it doesn't matter what the process is." (Philip)

Fundamental to this assessment of whether a business is viable is the early assessment by an administrator of the business's financial and operational trading position. This includes the potential for capital to be injected into the business, in the form of either additional debt by supportive financiers or shareholder's equity.

That sometimes involves a conversation with the external accountant or the CFO, and that's how we start to formulate a picture. And industry experience comes into this as well. Running through things like what debtors do you have to collect and what do your cash receipts look like over the next month and what payments need to be made for fuel, for wages, for rent, what are all the different expenses that are coming up –and when you look at that on a piece of paper you can see quite clearly that there is a million-dollar gap here. There isn't enough money to pay for all these things, so where is that money going to come from? Will the directors put that money forward or will their financier or their bank put that money forward? And if the answer to that is no, then it is not viable." (Leslie)

Even with a business with prospects of salvation, for a restructure to successfully occur within the existing corporate structure, participants asserted that the potential for injecting additional equity or recapitalisation was a key success determinant.

> *"But generally the sort of things that you're looking for to determine whether there can be a successful voluntary-administration are whether there is an additional source of funds to be injected beyond the assets that would be available to a liquidator; [or] alternatively, a prospect that certain unsecured creditors in a liquidation are willing to step aside or compromise their position, producing a bigger return to other creditors. Or a delayed realisation or continued trading of a particular asset that would result in a greater sale price or continued profit stream than would be available in a liquidation. I think that the usefulness of the regime will come down to whether you can identify one or more of those factors." (Jamie)*

Once again participants identified the catastrophic implications for some viable businesses to disintegrate as a result of the *ipso facto* clause barrier to using the formal appointment process.

> *"Factors which will affect the viability of a business and the likelihood of rehabilitation can be varied. However,* ipso facto *clauses in my experience are a really significant issue because you will frequently encounter in practice many of the company's key assets tied to the continued availability of supply, or otherwise the enforceability of contracts that can be terminated as of right if an insolvency event, including a voluntary-administration, were to occur. So in my view it is a real issue in potentially retarding the viability of a business that is available for use in a voluntary-administration, or something in which reform*

may certainly be justified. Because to me it represents a real impediment to the successful utilisation of the regime in certain cases." (Alex)

Even more detrimental for business viability and underlying value in a restructure scenario is the absence of long-term contractual commitments with counterparties.

"The barriers with ipso facto *clauses sort of assume that you have committed contracts with people. I mean often one of the barriers we often encounter is that you don't actually have long-term commitments, in which case there is probably nothing you can do about that, it is just an inherent weakness in the business. We have seen a number of businesses that rely heavily on contracts with businesses such as [the major supermarkets] who don't commit to any volume arrangements – you are just grateful they buy anything from you, in which case there is nothing to preserve. In those instances, those businesses are potentially worth nothing at the end of the day because there is no underlying value in those contracts other than the hope that they will continue to buy off you." (John)*

Participants saw a number of contributing factors or characteristics of a viable business that were essential for a successful restructure of a company, including market share, position and relevance.

"You need to have a business that has some significance within its market and relevance within its market. If it is a really insignificant business and of no relevance within its market, then the pressures that that business comes under

through an insolvency generally mean that people can drift away when it comes down to it. So I suppose if I had to sort of conclude on that, the keys are a material business with reasonable market share, significance within its markets, strength of relationship with its customers, reasonable management team." (Dale)

The absence of these key characteristics was reportedly a significant inhibitor to the percentage of businesses that come into that framework with the potential to be restructured.

"Probably 20 to 25% are viable businesses, would be my guess. If you have a business with very small market share, narrower customer base, less engaged management team, it is a business which can easily just…customers can go elsewhere and it will not survive the strain of insolvency. You need a range of things that creates the glue to hold the thing together, to deal with the stresses of insolvency on businesses. And the less they have, the greater the chance that the business falls away. In terms of practical barriers, you just get one of two things. One is nobody's got the money to spend to invest in it and the other is the operators are just tired." (Julian)

In an insolvent-company scenario where a recapitalisation or DOCA was not feasible, participants reiterated the importance of a viable business to facilitate a successful outcome.

"A successful outcome fundamentally comes down to the business. What a DOCA does is provide an opportunity for equity to be introduced in a context where someone would not put equity in, or alternatively it needs to be recapitalised. But that pretty rarely happens, particularly at the smaller end of town. Does this decrease the likelihood of the business continuing on – i.e., employees still employed, customers still serviced, suppliers still supplying? I don't think so if there is an underlying viable business. It just means often you are running a sales process and getting value for creditors that way." (Dale)

Alternatively, where businesses were not viable as a whole, participants saw value in the VA process to provide an opportunity to identify segments within the business that might be salvageable.

"What is great about the VA process is that you can pick and choose and you can say, 'Well, that bit of the business isn't [salvageable] but this bit is,' and we can restructure around that, so that works." (Philip)

In the larger corporate space where there was a strong viable business and where corporate distress was more a function of gearing levels than underlying business profitability, participants saw opportunities for schemes of arrangement to restructure and avoid formal insolvency.

"The ones we worked successfully on a scheme [with] or something like that has been worthwhile, because there was a very viable business which was just over-

levered. Often great businesses making lots of money, good cashflow coming out of it, with just too much debt they can't sustain. It is just about how you re-stripe the balance sheet to properly recapitalise it, what's otherwise a good business." (John)

Participants saw less applicability of the scheme of arrangements for SMEs seeking to restructure, in the absence of a very significant business upside. This was due to the significant time and cost of the process, which distressed companies often don't have.

"I think it is a challenge for companies in the mid-to lower end of the market, where there is perhaps not a hugely valuable role, you need a lot of upside to bother going through that process. So it needs to be a very strong underlying business, and the ones where we have seen some potential for it to happen have had very good cashflows and very good profiles as a business, and just needs the re-cutting of its balance sheet." (Shannon)

The findings reinforced the critical importance for a viable business to underpin a distressed company for it to have any prospect of success under the framework. Whether the existence of such a viable business resulted in the restructure of the company or the sale of the business, was identified as being contingent on effective balance-sheet recapitalisation and the best form of realisation to benefit creditors. The likelihood of businesses surviving the stresses of insolvency were highlighted as depending on the broader strength of the business, including underlying contracts, market share and position and customer base.

Books and Records and Reporting Systems

A number of participants were critical in their assessment of the books and records and reporting systems maintained by companies they had encountered.

> *"Ninety percent of the time [books and records are] absolutely appalling, even companies that are listed are appalling. It's unbelievable the amount of things that just slip through and I don't understand it. Even most of the public companies that I've looked at have had deficiencies. And it's not to say public companies should be perfect. Of course we should all strive for perfection, but you're listed – it should be fully transparent what you're doing, and your shop's in a complete disarray behind the scenes." (Cameron)*

Participants flagged concern about poor reporting systems and books and records resulting in directors making decisions based on gut instinct rather than timely information reporting, particularly among SMEs.

> *"I think if you look at where the market is going now, it's going more to the SME space, which is made up, I guess, of a large number of family-owned companies, and they're making strategic decisions on their gut. They often come undone with that, and when you start to build size, as you can appreciate, you need to actually get the info. How do you make decisions without knowing that information? You know you're getting P&Ls that are produced two or three*

months too late, what's the point? If you've got a seasonal business, the ship's gone." (Dale)

This lack of financial information and record-keeping often meant a failure to recognise problems in the business in a timely manner, before a company became insolvent and a formal appointment was required.

> *"Look, I think typically in Australia we find that a lot of our businesses don't have good record-keeping and they don't have good forecasting and budgeting. So often you find that if something had been done to recognise what was happening in their business and what the drivers of their business [were], that if you could have restructured or done something at that point, you wouldn't have got to the VA point; you would have been able to restructure it. We have gone into major companies and sometimes you are just knocked over by how little and how inaccurate the stuff is." (Lee)*

Indeed, many participants noted that company size was not an accurate indicator of the likely quality of accounting and reporting/record-keeping systems, reporting deficiencies across the size spectrum.

> *"Having got to the point now where you've got size of the company, [that] doesn't necessarily change the quality of record-keeping, behaviour and culture of those organisations. A large company should…by definition have better systems. So I think in theory it should be easier for the practitioner to get*

information to review it. In practice, however, that doesn't always work. Then in the SME space, quality and completeness also varies considerably, with businesses that are deficient in their record-keeping, usually due to a lack of knowledge, lack of prioritising or for cost issues." (Taylor)

Participants noted that this presented a challenge to administrators upon appointment, where poor or missing financial records and reporting inhibited the likelihood of trading on the business, particularly given the short time administrators had to get their head around things, as well as the issue of personal liability.

"The risk is where the company's internal financial reporting systems are so poor that it doesn't eventuate until one or two weeks after the administrator has been appointed that the company is actually trading at a loss, every single day. Where this is the case, we find ourselves in the position where we need to almost recreate the profit and loss account to figure that out after we have been appointed. So there is little else that can be done other than to shut the business down pretty quickly, because quite simply we aren't able to sustain the fundamental business." (Leslie)

Participants also noted that inadequate record-keeping and reporting significantly increased the difficulty for an administrator to recommend a DOCA proposal or restructure.

"To recommend a proposal, an administrator has to have some comfort in the reported financial position and the performance of the business [as] evidenced by its records. If the same parties are going to control the business going forward, there needs to be a recognition of the importance of good and accurate records to measure performance and address issues relatively quickly, rather than waiting for significant periods of time for issues to become apparent." (Sam)

Participants also identified a greater role and level of accountability that auditors should be held to in ensuring that companies had adequate books and records and quality of financial reporting.

"But it's to the point in Australia that I do see that, that there's been things [about which] I've said, 'Well, how does that work, how did you get that through the auditors?' So whether the auditors need to be held to a higher test …I always sort of start with the scratch test. If I find out something in a couple of weeks, then that just tells me the auditors haven't done a good enough job… there's still big gaps in reporting, I think, that they need to improve." (Cameron)

The findings in this section have shown that the impact of inadequate books and records and reporting systems have presented a far greater and broader barrier to corporate management and sustainability than suggested in the literature – transcending corporate size and any distinction between public and private companies. Particularly for

distressed and insolvent companies, the absence of accurate and timely reporting and records significantly decreased the likelihood of business survival and rehabilitation.

Employee Entitlements

Most participants raised the issue of employee entitlements as a barrier to corporate restructuring. In particular, they emphasised the quantum of those entitlements and the inability to compromise those entitlements to facilitate a restructure or sale of business.

> *"Employee entitlements are very important, but when selling a business, the various categories of leave and other entitlements that they might have accrued often result in quite significant liabilities on the balance sheet, which I have seen destroy business sales. So the business simply cannot be sold because the purchaser cannot take those liabilities onto their balance sheet. Nor can they employ those employees separately – i.e., try to buy the shell and employ the employees separately because they still have to take on the entitlements within a three-month window, or something along those lines. So the employee-entitlements issue is one that would be worthy of attention, particularly if there was scope to have employees agree to compromise their entitlements in some way, shape or form, then that should be up to them." (Leslie)*

Participants felt that the addition of flexibility of employee entitlements within the Australian restructuring framework was a worthwhile consideration to ensure that businesses burdened by legacy entitlements remained viable.

> *"I think employee entitlements are an issue, in terms of that's probably the one we would encounter the most in practice. My personal view there is that change would be a healthy thing for businesses that are strangled by that sort of overhead, and are badly hindered by legacy employee arrangements which are going to make it hard [for the business] to survive in its current form." (John)*

The Part 5.3A regime's inability to restructure priority employee entitlements to facilitate restructure was contrasted with frameworks in other jurisdictions.

> *"But, you know, one of the differences between Australia and the US is that you can crunch down the employees, and that's in fact what the airlines have done. You look at [an Australian airline], for instance, and you say, 'Well, what is the real problem here?' I have been looking at them for a while and thinking, how do you reengineer those contracts? Well, if I was in the US jurisdiction I would use Chapter 11 and I would crunch the employee entitlements and start again. But you can't do that under the Part 5.3A legislation." (Cameron)*

Some participants discussed the need for greater flexibility with employee entitlement priority where external funds were being injected into an insolvent company, to enable a return to broader creditors, which would help secure support under a DOCA scenario.

> *"One issue in practice is that if the funds from a proposal are coming from a third party and not from the company's assets, then it is sometimes impossible with the size of the employee entitlements to get a return to the creditors,*

because you can't vary that proposal. I think the priority, it's reasonable that you can't vary the priority out of the pool of assets the company itself would have generated. But I don't think it is reasonable when the funds are coming from someone else, to then take that flexibility out of the proposal you might put up, which is still genuinely in the interests of creditors, which would allow you to bypass some or all of the employee entitlements." (Dale)

However, participants felt that the right to compromise or cram down employee entitlements should be with the agreement of the employees themselves and not by the order of a court.

"I think it should reside with the employees personally. And I think that if you tried to get a court order on something like that, the court would take a similar view because they are accorded priority, and I think that notion is attractive to the court". (Jamie)

This protection was largely driven by an underlying concern that employees often were not informed of the financial state of their employer, particularly in relation to the state of their entitlements.

"Employees often get very little information about the creditworthiness of their employer, so they accrue these entitlements in an open contract that the company gives them. They have no visibility of the credit they are taking on, and I think they should be protected. I think particularly at the smaller end of the

> *market, there is a lot of abuse of process by small businesses, who find it hard to get by. I think we miss this, working for a large institution, working in the city. Every now and then we see a small business and, you know, the people who are working for small businesses are generally relatively disadvantaged people…and I think they deserve some protection.” (Philip)*

In this regard, it was clear that participants’ political ideologies influenced their position towards employee entitlements, which will be discussed further in the section on culture.

Participants also flagged concerns that employees would be reluctant to compromise their creditor entitlement claim under a deed of company arrangement, because of concerns for the sustainability of the restructured company or new business owner.

> *“There is a barrier, because in reality the idea that you’re going to put a DOCA up that covers all those employee entitlements…you’ve got no chance. Because people will go, ‘Okay, great, so you have cut off part of my entitlements, the business lost money for the last five years – why is it going to make money next year? So I have cut down my entitlements and I probably have still got the same risk of this thing falling over again anyway, or alternatively they’ve been transmitted through a business sale to someone who may be as insecure as the company they’ve come from. Why should I take that risk when I can get my entitlements and go and get a job elsewhere?’” (Evan)*

Significantly, another barrier that participants identified was the incentive for employees to lose their jobs and be guaranteed a majority of their entitlements through the government's General Employee Entitlements and Redundancy Scheme (GEERS), rather than to support a proposed restructure or sale of business.

> *"I guess in terms of adding to the list [of barriers], one you might want to contemplate is, funnily enough, the government safety net GEERS, because it is one that cannot be utilised for restructuring. Employees – and through their unions in particular – now look at GEERS, which has got vastly improved entitlement parts to it since the beginning of this year. So unless your deed proposal is superior to that in terms of employee entitlements, employees would prefer to be made redundant. When we are talking with highly unionised environments such as building construction and manufacturing, they're going, 'Oh well, that deal, whilst it squares everyone else away, it's not as attractive as triggering our redundancy entitlements and holding our hand out in six weeks time for a GEERS payment.' So whilst it is there for all the right reasons, it actually can be a major hurdle to overcome to get what would otherwise be a commercial deal across the line." (Taylor)*

Participants identified this inflexibility around compromising employee entitlements as not only affecting the potential for retaining employment through the restructure of distressed companies, but potentially also the returns to unsecured creditors.

"So here's a company we took through the voluntary-administration, and we were trying to do a genuine restructure, and that restructure was paying employees 50 cents in the dollar for those that we terminated. Those that we kept on, we paid them as normal under the award, kept their entitlements going. But then we had to get the trade creditors on side so we gave 10 cents in the dollar or something like that. The whole deed was destroyed because the community said, 'No, you have to pay employees 100%, you cannot get out of an employee entitlement.' So I understand the theory, but when you compare it to the alternative, which was liquidation, which was employees claiming under GEERS, trade creditors get nothing, all employees get terminated and we've lost the business. I always treat insolvency as common sense and that just strikes me as nonsensical. The whole thing gets torn down because we've got to pay employees 100 cents." (Cameron)

It was also felt that employee entitlements as a barrier to restructuring had been compounded in recent years due to the rise in quantum of entitlements, which burdened distressed companies.

"The other thing is just with the creeping entitlements over the years, the amount that an average employee is entitled to has become so large, collectively, with a number of staff it has become a major piece of the liabilities of a company." (Julian)

This was attributed in part to the substitution of increased redundancy entitlements for pay rises in some unionised industry sectors, where employers sought to defer the cashflow impact of short term wage-expense rises.

> *"You know, what's tended to happen is unions, particularly in certain sectors where they have struggled to get pay increases, what the company will always give away is a bigger redundancy. I can't pay them more now, but I will give them a few weeks extra redundancy, fine. That's become, in a lot of, particularly, older industries, where there has been structural change like, say, the automotive-components industry, and where there is a bit of insolvency, that's starting to become an issue. You get some big number because there have been guys that have been there a long time and the unions negotiated up and up and up. So employee statutory entitlements is a barrier." (Chris)*

Participants also felt there was a misconception in the public arena as to what had happened to funds that should have been available for employee entitlements of an insolvent company.

> *"I also think that the public notion, if you like, that employees entitlements are sitting magically in insolvent companies in some slush fund somewhere, that has been siphoned up or given to somebody else, when the reality in pretty much all insolvency situations is that the company never had the money to pay those entitlements in the first place. Not that they put them somewhere, or stashed*

them or have stolen them or whatever, that perception fuels the hysteria around employee entitlements which makes that very inflexible." (Alex)

The findings in this section outlined the barriers to restructuring as a result of an inability to compromise employee-entitlement claims under the existing legislation, and highlighted the challenges this created for companies and businesses with large legacy entitlements. Participants advocated for greater flexibility surrounding this class of entitlements, and flagged the potential for employees themselves to determine whether a compromise was acceptable under a restructure to facilitate ongoing employment and the sustainability of the business.

Practitioner in Possession (PIP)

One of the key barriers participants raised in relation to the practitioner-in-possession model, such as voluntary-administration, was the challenge of obtaining additional finance funding during the formal restructuring period, particularly given the administrator's liability around incurring such debts.

"Look, I think it's a bit of a problem, because if you're a voluntary-administrator you've got to sign up completely. In other words you're personally liable for any facility you get from the bank, and you can't offer the assets of the company effectively if there's another bank in there with security. That makes it difficult to do that, and a VA is personally liable for any debts that

> *they incur, so we've got very tight constraints around those sorts of things." (Lee)*

The limited availability of administrator funding was contrasted with the situation in some overseas jurisdictions where debt funding appeared somewhat more attainable, whether it be on a priority basis or provided by the incumbent financier.

> *"The other key tool that I think we need to take out of the US market is the debtor-in-possession funding. I think that is something the Australian market hasn't got its head around. Where used it can be very productive, so a company goes into a process, and there is funding given to the company with a second priority. And whether that priority sits above or next to or below the secured creditor, that's going to depend on circumstances. But I think there needs to be a way to get fresh capital, for an administrator to get fresh capital and fresh funding into a business, especially a trading business, quickly, so that they can maintain value without a 'tying up assets' strategy. That's what happens in the US and it's very difficult to do here." (Jamie)*

Participants did acknowledge that some progress had been made to facilitate finance funding for companies in administration. This included such funding receiving priority recourse as a cost of the administration, and potential limited liability recourse by the financiers to the administrator. However, participants observed that the prevalence of such funding in practice was uncommon.

"There have been some tweaks that have been of assistance to administrators to allow us to minimise risks relating to how we can get finance to fund the administration. In particular, the financier can have comfort that will be deemed to be a cost of the administration, and therefore have priority in terms of the waterfall that comes out of the eventual proceeds or the sale of the business or assets. Also, you can engineer it such that the administrator has limited recourse in terms of that loan, such that the only recourse against the administrator in terms of the repayment of that loan is to the extent that there are assets available within the company to pay it. So if you can find a financier and deal with that financial risk, then you can pretty much do most things between the parties funding the administrator. However, the provision of such funding remains an infrequent occurrence." (Evan)

Notwithstanding the limitations of obtaining additional funding, in an Australian context participants identified substitute challenges in adopting the debtor-in-possession model (DIP) scenario. This included the risk of the company further damaging the position of creditors by incurring additional losses during the trading restructure period, and the likelihood of that risk being adequately tracked and contained.

"The problem with the alternative of debtor in possession is the same guys who have got the business into trouble, usually in our experience are not very good in tracking how their business is actually going. All of a sudden the business loses another few million dollars, and you have effectively got insolvent trading in a debtor-in-possession context. And I think that would happen a lot. Whereas

administrators are much more focused on: 'I am personally liable, there is no corporate veil for me. I want to understand the numbers quickly because I am new to this, got no baggage. Either someone is on the hook to fund me and it's not the suppliers, or I'm shutting it down.'" (Philip)

This was identified as particularly relevant in any further consideration of an informal restructure framework, including in the context of the introduction of a chief restructuring officer, which would likely constitute a quasi-DIP model.

I mean the protection is that I'd assume you would have a registered practitioner as CRO with all the requisite experience and qualifications. So you'd have that there as a protection to make sure that the situation didn't deteriorate. So I think there is an opportunity to do that, or even to go that next step and have someone appointed by a court to do the things they've got to do and report back to the court. I think that could be another way of doing it." (Lee)

Participants raised concerns over the probability of ongoing supply in the Australian context, where previous amounts owing were put on hold and suppliers were expected to continue trading during the restructure under a DIP model.

"I think that in Australia one good thing is that if you go in as a VA, you almost always get continuing supply. You're saying to suppliers, you're an unsecured creditor, open a new account and you're guaranteed payment. And it is very

rare that someone says, 'Nah, stuff you,' which is a bit surprising. I am not sure in the Australian market, if you said it's debtor in possession, here's the same guy that's running the business…who says, 'G'day, can you just pause that account and open a new one for me.' I am not sure how that really plays out. I don't think that would work very well." (Philip)

Participants also questioned the premise of how much the debtor really stays in control of the company in DIP-type models such as the US Chapter 11, with the role of the advisors and courts there to try to protect stakeholders' positions from further deterioration.

"In Chapter 11, everyone goes, 'Oh but the directors are still holding the reigns of the company.' Well, that is not really true. The truth is, okay, yes, they have got all these advisors sitting over the top and they don't do anything other than what they are told to do by people like me, so that is something we have got to change [in] peoples' understanding of Chapter 11. There is a real misconception…. Some of the things are quite appealing in the way they go about it. But I think we can achieve these changes without a full move to Chapter 11." (Cameron)

With the practitioner-in-possession model, historically participants identified challenges for administrators wanting to understand a company's operations in the tight timeframe required, particularly for larger corporate collapses. However, participants reported that

alternate approaches were increasingly being developed and applied to overcome these constraints.

> *"We are working towards a model where we try to very much keep management in place. Look, our approach to that as insolvency practitioners - in that situation, we should be project managers and effectively take the position of the Board or the CEO, and not necessarily try to be the management. I would say it is very rare that an insolvency firm in any industry could argue that they are better operators or in a better position in an industry than existing management. You know, putting aside fraud or clear management problems." (Jamie)*

There was increasing recognition of the benefits of retaining the management team from an operational perspective under a practitioner-in-possession model, along with the ability for cost containment of the administrator's professional fees during the restructure period.

> *"It takes time to learn the dynamics of the business and the relationships within the industry. So I think that's one of the things that is changing in the insolvency industry. The industry, especially on the larger files, is more [often] taking that approach and keeping management in situ. And you've seen in some of the larger ones, and certainly in the retail sector, there is no way that an administrator or a firm of administrators can deal with thousands of retail outlets scattered around the world. The only way to deal with those is to rely on the existing management and infrastructure, to get a better commercial*

> *outcome, as well as from a cost-management perspective of the administration." (Dale)*

Participants also flagged the potential for administrators to successfully operate a business during a restructuring period through other creative mechanisms, such as running businesses under license by third parties to capture the benefits traditionally reserved for a DIP-type structure.

> *"Where the practitioner-in-possession model comes under the most strain is where there are large VAs with, for example, a geographically diversified presence around Australia. And that obviously takes a lot of time and resources. I think in these circumstances the administrator model can still work effectively by utilising - if people are willing to be flexible in how an operating framework can work during a restructure. In fact I am currently advising a job where the VAs have engaged someone to operate in there under a license to run the business… as long as the administrators have strict requirements and reporting from whoever they have as a licensee. I think that approach makes a lot of sense and saves a lot of cost. Because they can set a framework as to what they want them to do and how they want them to do it, which can be audited. They should be able to protect the company and the creditors by putting those things in." (Adrian)*

There was also perceived value under the practitioner-in-possession (PIP) model to take the business out of the hands of the directors to facilitate a restructure. Some

participants were of the view that the need for restructure should necessarily preclude directors from maintaining control of the distressed company.

> *"I think taking it out of the director's hands for a period and being able to have an objective view…because as I understand Chapter 11, the directors still operate the business to an extent even if it goes into Chapter 11. So I think that's like leaving a fat kid in front of a candy store. If they didn't need Chapter 11 protection they wouldn't be there. So why are they being left in charge? Give it to someone else to rehabilitate then hand it back to them. But I just think our system is actually quite good and I'd be loath to go more towards that Chapter 11 framework." (Alex)*

Participants acknowledged that the PIP model presented a number of traditional barriers to efficient restructuring, including access to funding, failure to effectively use management and lack of industry and operational understanding. Notwithstanding, there was broad support for the PIP model to deliver independent and objective restructure outcomes, with the findings advocating for the integration of a number of DIP model characteristics into the existing framework. This included structural change to incorporate greater retention of management in situ, and the operation of businesses under license where required, to facilitate cost and resource containment whilst allowing administrators to better focus on the strategic restructure and rehabilitation of the insolvent company.

This section has discussed the impact of the key practical barriers identified in the research findings for the effective rehabilitation of insolvent Australian companies. The findings highlighted the issue of director quality and failure to detect early signs of distress and take timely action, as well as the importance of maintaining communication and trust with stakeholders through the restructuring process. The underlying viability of businesses was then examined as a major inhibitor of insolvent-company restructure, along with the characteristics critical for survival of the Part 5.3A process. The section then proceeded to report on the barriers created by inadequate books and records and reporting systems, the prevalence of this issue across a broad range of company sizes and its impact on achieving a successful outcome. The issue of employee entitlements and the inability to compromise claims was identified as a key challenge, particularly with the trend toward an increasing quantum of legacy liabilities. Finally, the section highlighted the challenges associated with the practitioner-in-possession model and advocated for enhancements to this approach to provide greater efficiencies in restructuring and focus practitioner resources where most required. Barriers were thus identified as being both legislative and practical in nature. The next section will go on to consider the cultural factors influencing corporate restructuring in Australia.

CULTURAL CONSIDERATIONS

The restructuring and rehabilitation of insolvent Australian companies occurs within a context unique to Australia; this context is intrinsically linked to cultural values. This section will report findings relating to the insolvency environment and, more specifically, the operation of the Part 5.3A framework, with regard to the cultural

drivers for corporate failure responsibility, accountability and blame. The findings will then examine the role of culture and Australian industrial-relations policy, to consider the issue of compromise in employee entitlements as a creditor class in restructurings, in line with overseas jurisdictions.

Focus on Accountability and Blame

Participants reported that formal insolvency in Australia was tainted by the perception of corporate demise and collapse, with this stigma attaching not only to the company itself, but also the directors and management.

> *"There is undoubtedly an inherent stain of failure which companies are tainted with in Australia…there is definitely a stigma that attaches to and does damage to stakeholders' reputation in the market, particularly relating to the directors and senior management of failed companies. That is a powerful motivator for directors to avoid formal insolvency at all costs, notwithstanding the potential downside that this brings." (Cameron)*

This stain of failure was contrasted to overseas jurisdictions where corporate restructure is a prioritised objective and, if successfully achieved, is considered a testimonial to the company's robustness and corporate track record.

> *"I think of big US companies like American Airlines, JAL, Chrysler, General Motors - no stigma there. It's kind of like par for the course of just getting the*

capital to take a hit and then we just move on with the new. But we don't kind of have that here, we haven't really gone to that 'keep the business going' type of culture, and I don't know why that is." (Evan)

Many participants felt that this cultural stigma of insolvency was a key driver for the preference for and increasing prevalence of informal restructuring within the Australian market.

"One of the advantages of an informal work-out is it can operate below the radar screen, so you don't get the headlines on breakfast TV, but you do get a successful result, so you don't get some of the damage that can happen to a business through a formal insolvency process. I think that really is a sleeping issue and it can do great damage to a work-out process for things to suddenly be on the front page, particularly when they are taken out of context, which tends not to be a great experience for directors." (Cameron)

This stigma was extended to the role played by senior creditors as the catalyst for corporate insolvency and formal appointment, which has seen a trend to sell down high-profile exposures rather than risk being tainted through the insolvency restructuring process.

"I think this is a fallout from the recent culture of bank bashing which we have seen in the Australian market, which is obviously a factor for lenders. There will be some situations and some particular industries where it is sufficiently high-

profile that a lender will not want to necessarily be the one to appoint due to reputational factors. We have seen banks selling out of their debt to avoid being in the position to have to take that action, to leave that to those nasty debt traders." (Adrian)

The negativity surrounding corporate insolvency in the Australian market, often perpetuated by the media, was identified as unique compared to that experienced in other overseas jurisdictions.

"The attitude in Australia is [that] failures in Australia get a lot of press and a lot of negativity, and there is a lot of blame to it. That attitude does not prevail anywhere near as much in the UK or the US as it does here." (Philip)

Participants viewed this blame culture as something that permeated all sectors of Australian society; this, in turn, underpinned the need for administrators to investigate the conduct of a company and its directors while trying to rehabilitate the company.

"Everybody wants somebody to blame in our culture, and the tone is set in all sorts of different ways, from the law to the parliament. Even public liability and OHS and all of those things are all based on 'somebody gets hurt, somebody must be at fault, and it's not the person who has been hurt'. So our whole society is based around a system to protect people from loss and injury, and that's a lot of work to try to change that and unwind that sort of system. I don't

know whether business is the place to start – it's only about money rather than health or crime I suppose." (Taylor)

Participants described preoccupation with the prosecution, prevention and blame for insolvent trading as a key characteristic of the Australian insolvency framework. In that regard, an analysis of the likelihood of successfully recovering funds and prosecuting directors for conduct such as insolvent trading became a pertinent consideration for creditors in voting to place the company in liquidation.

"Look, I think one of the things that is different about Australia and the US is that in Australia we're obsessed with insolvent trading, we're obsessed with prosecuting directors and laying the blame and stopping an insolvent-trading company continuing to trade whilst insolvent. So as a consequence of that we've gone to this VA process, and the VA process can result in – if it goes into liquidation – those directors being prosecuted in that context. Now if you look at the US system, it's more about, well, let's not obsess about whether the company has been trading whilst insolvent. In fact they don't really go into those issues very much at all, particularly in the early stages. So what they're looking at doing is saying, 'Okay, we want to make sure the business continues and employees keep their jobs, we are prepared to overlook some of those issues.' But culturally in Australia, we're not prepared to overlook these things in the context of keeping this business going." (Lee)

It was perceived that this focus on responsibility rather than business rehabilitation has developed in the Australian context through the policy focus of regulators on enforcement and director accountability.

> *"Well, I suppose we follow the British more than we do the Americans. But I think we've sort of developed our own little obsession. I mean I don't think the British are as obsessed with blame and that type of thing as much as we are, and certainly not the Americans. So I think, yes, it's something that we've inherited - the basic tenants of our law - from the British, and then we've developed it a little bit more, particularly by the regulators. They are really concerned that things be dealt with properly." (Lee)*

Participants noted that this regulatory focus on enforcement and the cultural stigma of failure for directors of insolvent companies presented conflicting objectives, which often resulted in a desperate pursuit of alternatives to insolvency.

> *"It is our regulatory environment and the position regulators take on prosecution, but also we don't have a business culture where directors are rewarded for seeing a company through a difficult period and a restructuring. And I think it's very much seen as…'it's insolvent and you've failed', and therefore you can see why in desperation directors hold on and on and on, in the hope that they can find a different alternative to that route, and it's only there as a last option." (Shannon)*

Practitioners noted that for administrators pursuing preferences or insolvent-trading actions, this focus on regulatory enforcement raised a challenge to administrators as to whether to continue an action, if the funds recovered from such action were unlikely to benefit creditors.

> *"There is an interesting dilemma with preferences and with insolvent trading. If, with any of those kind of insolvent transactions, a liquidator is contemplating taking on those actions, there are two schools of thought. One is that if you are not going to pay a dividend, or if you don't see there is going to be a dividend payable, then you shouldn't actually start it, because all you're going to do is increase the loss to all the people involved, if everything you're going to recover is going to be absorbed in costs. The other school of thought is that you should really pursue those actions regardless…from a social responsibility point of view to teach people a lesson." (Leslie)*

The subordinate priority placed on corporate rescue is also reflected in the reportedly "despondent" attitude towards restructure by Australian boards. Whilst the director's control of the company is suspended during the administration period, participants noted that the involvement of boards in the planning, development and execution of restructure plans, particularly for large companies, was rare.

> *"I think one other key difference when considering alternatives such as those in the US is that the Chapter 11 framework's first criterion is asking the question, is this company really salvageable…can it be rescued? Then the decision is*

made to throw all the resources into getting the company rescued. Whereas in Australia, particularly the boards of large companies, rather than planning and putting together an appropriate proposal to restructure and utilise the voluntary-administration and/or DOCA process to execute that, VA is seen more as director's throwing their hands up in the air and saying, 'This is no longer our responsibility, we're out of here.' This is the type of approach which we often see insolvent companies reverting to. And at the large end in particular, that is something we should be working on reversing." (Shannon)

In that regard, a number of participants were of the viewpoint that the ability of the Part 5.3A legislation to successfully restructure companies as a matter of course was hindered in practice by the underlying cultural and regulatory policy impacts of its operation.

"I think if the framework could in fact be used as a genuine restructuring tool…I think it has all the legislative capability, but perhaps not the cultural willpower at the moment to use it for that purpose. But the problem is [that] it is a cultural change which is a reflection of society, not just a reflection of business practice or a sub-section of the economy. I mean, so there is a need for some sort of explicit policy mandate that actually positively encourages cultural change around its use, which would give the voluntary-administration the potential to achieve its objectives." (Dale)

This section of the findings outlined the culture of corporate-failure responsibility, accountability and blame, rather than a focus on restructure in the Australian context and the stigma of corporate failure that has attached to the VA process. There was consensus amongst participants that the policy focus of regulators on the investigation of corporate insolvency concurrently with the pursuit of rehabilitation inhibited the likelihood of corporate rescue as a matter of course.

Industrial Relations Policy and Employees

Participants reported that industrial-relations policy had a significant impact on the framework within which distressed companies are handled. They were of the view that Australian culture limits the likelihood of legislative change to compromise employee entitlements to facilitate greater corporate rehabilitation in Australia, particularly with regard to the treatment of employee priorities.

> *"Well, employee entitlements and how you deal with them is always a big consideration, but in terms of cramming them down, I think culturally in Australia it's not feasible to expect that you will ever be able to. I think we are culturally too entrenched in a place where the rights of employees are sacrosanct. I think it would be really helpful if there was some ability to acknowledge that, but still have some flexibility in terms of timing and crystallisation and dealing with the issues around that. I think culturally we are too far gone in Australia to ever get to a place where we are going to be cramming employees down." (Shannon)*

There was agreement amongst participants that employees and their entitlements should receive special protection in any restructure of a company's creditors.

> *"I think employee entitlements are sacrosanct. I don't think there should be anything done to in any way disenfranchise any employee in relation to their entitlements. I don't like any concept that goes to that issue. I find it hard to think of anything that I'd be comfortable with in diminishing that. I mean sometimes the ideas that the employees put their entitlements in, you know like capital or something like that to change the capital structure, I don't know that works, because the employees just can't be properly informed. So I think that in the employee situation, they've got to be taken care of whichever way it's done." (Lee)*

In fact, participants thought any policy attempt to amend the current priority and protections around employee entitlements would be political suicide for a government in Australia.

> *"Yes, I think that the challenge is [that] no government is going to change the legislation to do away with any sort of employee entitlements. That's just going to be like, you may as well not even turn up on election day." (Adrian)*

Participants attributed the rationale for this perspective and special treatment to the historical underpinnings and framework of the Australian industrial-relations system, which was differentiated from that of overseas jurisdictions. Even for participants who

appeared not to have an ideology that prioritised the protection of employee entitlements, they still acknowledged the cultural force of such policies.

> *"Compromising employee entitlements might be great, but it's not going to fly in this country. If you just look at our industrial-relations history, to me that is just incongruous to where we have got to as a country. So yes, we can look at the US and say, 'Isn't it great that that's doable'…. We all know that in the US that has become an industrial-relations negotiating table. For better or for worse I think we are in really different territory…. If we'd try to do that in Australia I think we'd come at industrial relations from fundamentally different perspectives, and I just can't see us getting anywhere near the US in that regard." (Alex)*

Participants distinguished the position of employees from other creditor classes whose positions could be compromised under a restructure, and noted the cultural factors, such as trade unions and the political ideology in Australia, that influenced such protection.

> *"I think that it works off the principle that suppliers are more sophisticated and have an opportunity to do credit checks, and they make profit out of the relationship, whereas employees just trust that they are going to get their wage. I think you would struggle with change in Australia because we are a bit more left-wing than those other overseas jurisdictions. There are cultural factors in Australia where there is a union movement and we protect our employees. I think that is the right thing, quite frankly. I don't think employees should be left out in the cold." (Chris)*

A number of participants questioned the premise of whether the cram-down of entitlements, particularly in larger company restructurings, would actually materially enhance the likelihood of restructure anyway. This was compared to the cultural implications that such an ideological change would require.

> *"But the reality for large restructurings is that they really should be about financial sponsors and the equity more than they are about the people who sit in the middle. So, it's all well and good to say we want priority to cram various people down, but the reality is they're very rarely about employee entitlements to get the deal across the line. I think they are 'nice to haves' from other people's legislation, but not necessarily 'need to haves', particularly given the cultural standpoint around employee entitlements in this country." (Philip)*

Participants reported concern that the current policies that drive legislation like GEERS almost provide an incentive for a company to go into liquidation to guarantee employee entitlements. Further, participants reported that resources are wasted designing schemes that enable those employees to get through to GEERS.

> *"The employee position is further clouded by the existence of the government GEERS scheme. I think [GEERS] has been a big distraction in lots of ways, and I think if we could get rid of it as a distraction, because it really isn't intended to be that, then well and good. The employees' legal position is not just what they are entitled to as a preferential creditor, but if the company follows a certain*

path through insolvency into liquidation, they get to get 100 cents in the dollar by payment through GEERS. So to counter that impact from government policy, you are often forced to craft a restructure that enables employees to drop through into the GEERS scheme, which means the legal entity has got to get into liquidation." (Dale)

However, a majority of participants felt that the underlying preference for employees was the retention of their employment, particularly for those who were older or had less-transferable skill sets, and that there were worthwhile social considerations that dovetailed into saving employment.

"Practically what actually happens is that people want to keep their job; there's only been really a handful of people that have tried to ostensibly screw the company for a redundancy. Pretty much everybody I speak to is shattered that they've lost their job, and they would be jumping over themselves to keep their job - it feels like they're on board that they want to keep their job. Whereas if you lose your job, it becomes, 'Well, what am I going to do now?' and it's hard to remain optimistic that you're going to get a job. I guess it depends on your skills, but you know the people this really hurts is the people that are over, say, 40 years of age, or skills may not be quite in demand…you can sort of see how they might see things differently from, say, a young person." (Cameron)

Participants questioned the potential of the GEERS legislation to provide greater scope under a VA restructuring scenario, given the potential to use the government safety net

to protect employee entitlements that had been crammed down in conjunction with a DOCA.

> *"But my understanding is that the GEERS payments are always discretionary anyway, so you can apply, but whether you get it in a DOCA scenario I think would be unlikely. If you want to be certain of an outcome, you have got to drop the company through liquidation. I know that it's ideologically driven, this concept of employees, and that we have to look after their interests and all the rest of it. Now whether perhaps the government should step in and fill the gap for lost entitlements in a restructure scenario? I mean maybe economically the cost of that is much less than the cost of having these zombie companies pregnant with employee entitlements that simply aren't viable or competitive." (John)*

Participants acknowledged the important role of culture and industrial-relations policy had on the protection of employee entitlement claims under the Part 5.3A legislation and the limited likelihood for change that facilitated compromises of claims or priority ranking of entitlements. However, they recognised the scope for enhancements to the GEERS framework to provide safety-net entitlement assistance to companies looking to restructure. They also highlighted economic and structural cost benefits in pursuing such initiatives.

TRANSITION TOWARDS A CORPORATE-RESCUE CULTURE

Participants expressed concern that the focus of the VA has evolved into a comparative exercise between executing a DOCA or liquidation, rather than on its primary objective of maximising the chances of the company, or as much as possible of its business, continuing.

> *"In the 1980s we recognised that we needed something between a liquidation and a receivership, and so we've come up with the VA. And sometimes the obsession with the VA – is it a liquidation or is it a restructure within the VA, in other words a DOCA – people look at it and say, 'Okay, let's compare the two.' So there's this obsession with 'can we get enough for creditors, you know what is it worth if we sue the directors, what is it worth if we pursue preferences'. So that comes to a figure and then you compare that figure with, okay, how does it look on a VA side – so, the DOCA versus liquidation. So it's kind of a situation where you're still weighing up the liquidation approach against a restructure, effectively, which is in contrast with Chapter 11. They're more looking at 'okay, we're not worried about some downside, we're worried about whether you can keep employees in jobs, the business can continue, etc.'" (Lee)*

This led participants to question the prevalence of true company restructures within the voluntary-administration framework, given anecdotal evidence of the low number of successful DOCAs.

"It is not restructuring in Australia. Using the VA and saying 'I'm restructuring' is not a restructure, I don't think, it's sort of…just running through a sale process. Yes, it's dealing with the problem, but it's just an ordinary liquidation with the protections of some moratoriums, and that's what tends to happen. I mean, look at the very low rate of successful DOCAs that have been true deeds. True restructures of the business and trade on cash flows - come in, pay the creditors out up to a cap - I'm thinking very few. So all the others have been a sale of the business and the creditors take a hair-cut, or an orderly liquidation, so the deeds aren't the magic tool." (Cameron)

Some participants felt a baseline minimum percentage return to creditors was a key determinant of a successful deed with a meaningful outcome for creditors, and should be required under a DOCA.

"It is also troubling where you get some really marginal DOCAs put through where it is five cents in a dollar or something, that's troubling. Should there be a minimum, a statutory minimum by which you can't put it through unless you get some minimum meaningful return? Because that also makes an awful lot of creditors sceptical…an awful lot of cynicism out there by everybody, including creditors, and that sort of defeats it. Because when you get someone who's been burned a couple of times, either on the directors side or the creditors side, they tend not to support the process going forward next time, and that all feeds itself. I can think of examples of DOCAs where people have offered one cent in a

> *dollar and it got up because of friendly creditors. That sort of return, I would think, even if a DOCA was agreed to, that is not a successful outcome. So a company that's viable at the end but also where creditors have not been completely stripped of a return." (Chris)*

Participants recognised stakeholders' underlying aspiration for a robust economy, and that an effective corporate-rescue framework was critical for ensuring the efficient operation of corporate Australia through the economic cycle.

> *"So I think that there is a desire from everybody, from insolvency accountants right through to bankers, for a preference to have a strong economy. And these sort of cleansing things that will happen are also part of that market cycle. Rather than what seems to happen now in the economy [is] that we've got the position where everyone's reluctant to get the adviser in, but then they sit there dormant because no one's willing to do anything about it and they become like zombie companies sitting there. At some point in time there's going to be a market downturn. Things have to be cleaned up, and unfortunately people don't plan for the rainy season. They just think it's going to go on forever." (Adrian)*

In particular, participants identified the impact of distressed Australian companies' inefficient capital use on the spread of capital, particularly where capital constraints were evident in a market.

"If you look economically, Australia's got this massive shortage of capital and capital's being deployed to these businesses that just aren't working properly. They're not efficient, and so we need to redeploy the capital. Otherwise, if we don't redeploy the capital, we've got to keep looking overseas for it, and that can't continue forever. So how do we grow our economy unless we're efficiently managing our economy and the capital that's deployed down here? So to some extent a business that doesn't have a long-term future should just be wound up and resources allocated elsewhere where it's more productive. So I think structurally we've got an economic problem: that the insolvency laws don't alleviate the hiatus that we've currently got in the market and a lot of that might have to do with, say, insolvent trading and the blunt tool of the VA." (Cameron)

Participants identified capital restructure as pivotal to executing a successful overall restructure, with the operational component running secondary to or in parallel with the balance-sheet rehabilitation.

"I guess I tend to think of sustainable restructure as initially more of a balance-sheet exercise than P&L or whole-of-company, depending on how you think about that. So what initially is set out to be remedied is the balance-sheet bit; the operational piece can run in parallel and is often integrally linked, particularly in the planning phase. But more often than not, the operational component of the turnaround really doesn't kick in in a material way until a balance sheet piece is finished. But often that bit needs money, or at least has to

have cash flow freed up for something other than debt service, and often it follows a capital restructure." (Sam)

To ensure the effective use of formal insolvency mechanisms such as Part 5.3A in a corporate-rescue culture, participants felt it was critical that directors saw value in the framework and perceived the timely focus on restructure as pivotal in the discharge of their duties.

> *"I think there is an enormous amount of benefit from fostering an environment where directors feel not only confident in using the administration regime to do the right thing by their stakeholders within a company. But it should go further than that; they should feel duty-bound to do that, and be very heavily criticised for not doing that in circumstances where there was an opportunity to restructure and they've failed to do so. So culturally I think we have got a long way to go, and it absolutely needs to be the direction that we move in." (Shannon)*

Key to facilitating change towards a corporate-rescue culture included the need for reversing the negative dialogue and prosecution-driven impetus towards formal appointment, and a recognition of the commercial rationale to facilitate restructure in the interests of stakeholders.

> *"So, how do you achieve [a rescue culture]? I think the sooner we get away from practitioners and the practice being that directors are told that…they will*

be sued under 588 unless they put their company into VA, the better, because that sort of language is really unhelpful, and I think that happens all too often in terms of the sales pitch, if you like. So there [have] to be more compelling commercial reasons to do that and I think directors need an incentive and a disincentive to find that balance. And I think that at the moment they have got an enormous disincentive to go down that path…it's just too terrible and too great a stain on their name." (Jamie)

Participants noted that the challenge to greater director initiative as part of a corporate-rescue culture was the prevailing cultural reluctance to provide directors with flexibility and autonomy in the restructuring process.

"At least in terms of the system we have in Australia, whether it's company insolvency or personal insolvency, I've accepted, I guess, ethically that people should not be allowed much freedom when they can no longer pay their debts. Because they are playing with somebody else's money and not their own...and we don't generally allow those people to put assets in that situation beyond the reach of their creditors. So, unless philosophically we change dramatically from that position, then it will be quite hard to move to a more debtor-based system of allowing them to control their own future and be more involved in their restructuring." (Taylor)

Participants identified further policy challenges in the Australian market for the compromise of creditors' claims forming a pivotal driver for the recapitalisation of the distressed business.

> *"Well, I think that clearly if you can more easily cram down creditors, effectively what you are doing is recapitalising the business. Theoretically you are increasing the likelihood of it rehabilitating. Whether it then goes on and makes the same losses again and burns that capital up, who knows? If we call rehabilitation effectively recapitalising and going again, sure, it makes it harder. The fact that you have got to get the people that you are cramming down to, at some level, accept that, makes it harder. Again, in Australia for example we have a government scheme that pays employee entitlements if there is a shortfall. Nothing like that exists anywhere else, really - certainly not in the US. So the idea that you can cram creditors down is pretty contra with government policy." (Shannon)*

Participants challenged the proposition that insolvency practitioners inhibited corporate rescue because of an underlying focus on liquidation as the default outcome, instead advocating for their role in the rehabilitation framework as providing the most complete tool set to achieve outcomes.

> *"I think there is sometimes a perception that insolvency practitioners aren't great at turning around companies or being part of this rescue culture, because all we are interested in is liquidation. And just nothing is further from the truth.*

In fact, to create a rescue culture you really need insolvency practitioners, because trying to do a restructuring or a rehabilitation with a person who isn't a registered liquidator, and can't access those tools such as voluntary-administration and liquidation, is basically like going into a boxing ring with your hands tied behind your back. The protective provisions under voluntary-administration give everyone an opportunity to take a step back and work out what the plan is going to be and the best way forward." (Leslie)

Participants felt that for a robust corporate-rescue culture to prevail, insolvency practitioners needed to be provided with greater flexibility and autonomy in the restructuring process, even if it meant holding registered practitioners to a higher regulatory standard.

"But it's kind of like, well, you know I'm happy to hold myself to a higher standard. I'm going to have all these controls behind me and you can vet everything that you like, and because I'm willing to go and hold myself to a higher standard of accountability, then I should get the leashes pulled off me a little bit. You should allow me to go in and rely on me as a professional who has particular skills to go and do a particular job." (Leslie)

However, participants expressed concern around the credibility of the VA process in the market and the role of practitioners contributing to this perspective, particularly with regard to the provision of advice and costs.

"I think there is a credibility problem around VA, particularly around the costs of administrators, around administrators making promises that often aren't adhered to. We have a situation where the VA was probably more likely to be used more quickly in the early days – ironically, because people weren't as burnt. It is a very competitive industry in a way that it never used to be, and I think that can compromise some of the advice that is provided up front… they are not putting the time in pre-appointment. That is the first point, because why should they if they are not going to get the gig? Secondly, you get some people who might be trying to undercut the competition, lowball it, then they get in there and the fees are a bit higher than expected, then that person is forever is burnt on the VA process. So the next time they come back they leave it until further down the track, rather than jumping in earlier." (Chris)

Another challenge to a rescue culture was the increasing competitiveness in the insolvency field, with directors seeking to "shop the job" on cost, rather than the selection of the best skill set.

"They say, "I want you to quote for the VA," and you say you're going to do it for ten grand, and then Billy Bloggs over there says it's going to cost two hundred grand. Billy Bloggs is actually right, it will cost two hundred grand. The directors are essentially choosing and shopping with the creditors' money, and if I was a director trying to hide everything, I would, one, remove all the assets I could out of the company to leave the administrator with nothing, pay a really ordinary administrator 10 grand into his trust account and say good luck,

batten the hatches down and just try and get away with it. So if I was a creditor I'd say, well, I want the best guys doing this job because the best guys are going to have the systems, the procedures, the accountability to get the job done right." (Cameron)

This commodification of the voluntary-administration process also presented a challenge to attracting the best practitioners to achieve successful restructure.

"I think the culture's starting to come in, but still has a long way to go, because I see VAs as the commodity product, and there's massive price pressure on that. We've got to get more efficient, reduce the price, and it's not going to keep my best guys interested. No one wants to be an executioner, everyone wants to be in the planning stage. Somebody used to say to me, 'You're cooking fish and chips' the way the insolvency market's moving, it's like I'm wrapping up with yesterday's newspaper something that you cooked ages ago, and that's not going to keep my guys busy and interested and focused. What keeps the smartest guys - and that's what you've got to get, the smartest guys, in this space - what keeps them focused is creating things, working out how to go and improve the business." (Cameron)

The issue of insolvency-practitioner fees was tied to the need to attract the best people and to reflect the risk they undertake in terms of liability. There was the view that more work needed to be done to communicate this fee structure and justification.

"But you look at, say, the US. What happened was that they paid them really well. Really good people doing it and then they went, 'Jeez, time out here, these guys are earning too much money.' And so they went and really clamped down, and then they went and got shit people in, getting really bad results. So then they're back to the style they are now, attracting good people. I entirely get the fee-pressure point, no issues with that. In fact, I think we need to improve how we communicate our fees and how we earn our fees, but I'm a bit of a soft target. You look at some of the fees that these investment bankers earn on deals, it's massive. It'd blow your mind." (Julian)

There was a reported shift over the past decade from a primary focus on formal restructuring mechanisms like Part 5.3A for restructure to more-flexible informal tools.

"Yes, there is an increasing tendency by both sides of the divide, whether it's the bank moving through their distressed customers without effecting formal insolvency appointments, or, alternatively, distressed enterprises retaining a team of professionals to assist them to trade through their difficulties and implement restructuring techniques that do not necessitate a formal insolvency appointment. I think one of the features of this recent economic downturn has been the prevalence of these informal arrangements, with the preference being to other, more creative things that often involve insolvency practitioners providing advice, but not to take a formal appointment." (Alex)

There was support for the greater role of informal and turnaround advisory in Australia to better facilitate this idea of a corporate-rescue-based culture, which was thought to bring the potential of greater creativity and flexibility to a rehabilitation outcome.

> *"Turnaround advisory is a developing cottage industry where people who are experienced in insolvency concepts, but not insolvency practitioners, are taking on advisory roles for organisations with a view to implementing a turnaround strategy. In a way that would be more effective than would be the case in simply seeking advice from an insolvency lawyer or insolvency practitioner. Taking on a role acting as project managers and being in a position to implement more creative solutions, both insofar as their own professional costs are concerned and the skills they can bring to the table than would your rank-and-file insolvency accountant or insolvency lawyer." (Adrian)*

Rather than any sort of wholesale change, participants suggested some refinements to the existing Part 5.3A framework, complimented by these informal restructuring tools to assist corporate rescue.

> *"I think our existing legislation is pretty good. I think in a lot of respects we've got the balance right, and that time and experience [have] refined our regime to the point where it does work reasonably well. And I can't see that it's - at this stage - problematic enough to consider wholesale reform; that would warrant a complete change of focus such as a Chapter 11 type of arrangement. But the question of should we pick up on some of the concepts that exist in the US,*

> *concepts around facilitating greater informal restructuring, concepts that limit the* ipso facto *clauses…is a sensible thing for us to consider because it will enable us to maximise enterprise value, absolutely." (Alex)*

Participants expressed concern about the reluctance to change and evolve in the Australian context, including the failure of the federal government's Safe Harbour discussion paper in 2010.

> *"I fear that Australia's slipping here. You look at Chapter 11, it's been evolving constantly. I think for some reason Australia seems to be, whether it's just the political environment is not right…we've got to change. I think there is some room in here without too much tweaking of the legislation and without tossing out the baby with the bath water. Because in terms of legislative change, getting what you need with minimum impact on other key bits of legislation is more what the lawmakers prefer to see. There's really smart guys in Treasury and the Treasury guys know that an efficient economy has businesses fallout, and we've got a capital problem, so I would have thought it would be patently obvious that one of the areas we can fix the economy up is improving the efficiency of the distress base." (Cameron)*

Some participants had reservations about the DIP model and key aspects of the Chapter 11 process for a reassessment of the Australian Part 5.3A legislation, which they considered the most suitable framework for the cultural and judicial system in Australia.

> *"My observation of Chapter 11 indicates that that is the corporate-rescue culture on steroids. To see the incumbent management continuing to be paid bonuses and keeping their jobs whilst employees lose their entitlements and creditors are basically forced to continue to support the business, which I struggle with. So there aren't a whole lot of aspects of the Chapter 11 regime that I personally can see would improve our system and warrant wholesale change. I think our system is different. The Australian insolvency system and to a lesser degree the UK system obviously, have evolved over a long period of time out of Common Law principles and legal principles that apply culturally to our country. So we've got a system that suits us, and I think that if you tried to graft the Chapter 11 regime onto the Australian regime I don't think [that] would present a good solution." (Leslie)*

Participants flagged the risk of an overly debtor-friendly rescue culture creating anomalies in the market that could actually be counterproductive to broader corporate health.

> *"I also think that the ability of the Chapter 11 administration to create or to distort markets…and it's the classic case of, you appoint under Chapter 11, say an airline goes into Chapter 11, suddenly because they don't have to pay for their legacy debts and they've got their secured creditor locked in to some kind of low interest rate because of a court order, they can now fly people at cheaper prices, which then puts one of their other competitors into Chapter 11. I struggle with that too." (Lee)*

A consequence of the debtor-based model was the limited applicability of the process to the SME market, which represents the majority of distressed companies in the Australian context. Due to the cost and the requirement for court oversight, this left informal restructuring as the only viable option.

> *"The real problem that we would have with a debtor-based culture, as opposed to a creditor-based culture, where the creditors hold the power, is that Chapter 11 is exceedingly expensive. And consequently in the US you will only find that the very big companies actually do Chapter 11, and it actually locks out the middle market. Consequently they don't have a mini, cheap version of Chapter 11, so if you are not big enough to pay all the lawyer's fees to do Chapter 11 because it's debtor-based and court-based…very expensive…your only real option is hopefully to do an informal restructure. If you can't afford to do an informal or Chapter 11, you need to do a Chapter 7, which is just the wind-up. So that, to me, can actually destroy the ability to restructure, particularly in the middle market. It is an entirely different way of thinking about things." (Evan)*

In fact some participants felt that the real success of the Chapter 11 regime in practice has been the threat of the bankruptcy process to provide a catalyst to informally restructure insolvent companies, rather than pre-package a restructure in a formal environment.

"In the US they definitely do a lot more informal work, and I do not know if they use the threat of the Chapter 11 as the real knife to their throat, and so they seem to get a lot more things done informally from what I understand, speaking to those people over there. But if you look at Chapter 11, Chapter 11 is not successful as a work-out other than at the very big end of town. What's the useful tool is the informal work, the work beforehand. So my view is that pre-packs are a tool, but it's not the tool, it is a bit of a red herring in a sense. We should actually be trying to get these things done informally and deal with them even before we ever get to a formal process." (Cameron)

The success of a corporate-rescue culture was also considered to rely heavily on the timing of the decision to restructure, with the formal process often forming the catalyst for real change.

"I can probably count on my hand the number of times that you've been truly approached at the right time, so you can actually properly engage with the creditor body and strike up a deal. So, that's the problem and that's why you need to get in early. And I don't know if they get the warning signs early enough or their head is in the sand, but by the time the VA hits, predominantly it's too late. So I think there is more scope to start to move towards more an American philosophy of trying to save the business." (Lee)

"I mean, you crawl these companies because of our costs. So it's often been said, clichéd style, that but for the administrator's fees these companies are

> *actually not too bad. The fact is that you actually need a catalyst to change and [the voluntary-administrator] is, unfortunately, the catalyst." (Julian)*

This issue of timing and the correlation with corporate-rescue success was particularly prevalent for SMEs.

> *"Particularly with the mid-market SME companies, directors have usually drawn down all the equity in their home loan, they have borrowed from their parents and their friends and everybody that they can find, tipped all their money into the business and it's gone, and they have run out of resources and run out of ideas. That is where they are at when they have come to that process. Whereas, if they had embarked on the VA process sooner and had those assets available - for example to fund a recapitalisation or to fund a deed of company arrangement, it would have been a better story." (Leslie)*

Further clarity and flexibility around the independence guidelines for insolvency practitioners was seen as an important step to more seamless corporate rescue, particularly for restructures of size, and seen as key to any amendments to the informal restructure mechanisms being contemplated.

> *"So if you have a look at the independence guidelines of the IPAA, which absolutely will be enforced by ASIC and the courts and so forth, there is the ability to be engaged.... You have to give a very detailed statement of what you have done in advance, which I have no problem with. I think there should be*

complete disclosure around that. Where it gets tricky is when you have a very large group and you may have been involved for a very long period of time working through all of the various scenarios. There is a grey area in my view about whether the independence guideline around IA language is sufficiently broad to encompass all of the things that you might be doing to try and work through a restructuring of the business. I think there should be a debate and clarity around those issues and a clear course of practice." (Shannon)

Participants felt that for larger matters the existing independence framework failed to address the requirement for the often-significant participation required in the lead-up to formal appointment.

"I think the focus on independence is principally for the small matters where the problems arise. And the 'one size fits all' approach to that is rather un-helpful for the larger matters, because the wording doesn't contemplate the expansive role that you might very legitimately play trying to get to the place [where] you are planning for an administration that leads to a restructuring. What is unhelpful for everybody in the insolvency community, and stakeholders in the wider sense, is this narrow challenge of independence that you need to loop through for major and large restructurings. I think if we can do away with that, then we would be in a much better place to work through using VA as the primary restructuring tool." (Evan)

When questioned about the concept of corporate rescue and the role played by financiers in shaping that culture, participants felt that formal insolvency was no longer the preferred option, and recognised a shift in the market, including increased distressed debt trading at the very large end.

> *"I think that the banks who generally are owed a reasonable amount of capital have a corporate-rescue culture by and large. Insolvency is not their solution to the problem, and I think Australian banks have moved far closer to a corporate-rescue culture than in the past. And I think the increasing prevalence of debt trading has sort of moved the market. Because those guys who buy that debt clearly come with that objective, so they come with a loan-to-own objective. So the Australian banks' willingness to accept a discount works…the fact that the money is there to buy the debt works." (Dale)*

> *"I think the financier's role in corporate-rescue culture has come a long way in Australia in the last five years. Really, on stuff of size, insolvency has become the last option, right? People are looking at, 'Well, can I sell my debt?'*
> *People are looking at, 'Well, can we do a stand still, can we do a pay-if-you-can, can we re-tranche, can we do a forced term out? Okay, none of those.' We had an appointment recently on a big asset worth hundreds of millions of dollars, where what ended up needing to happen for the appointment to occur was when the director finally abandoned the company. So I think the culture is emerging." (Philip)*

Participants also identified the challenge for the Australian market around the credit-bidding concept prevalent in other markets such as the US, which has been an influencing factor for the use of schemes by debt traders with a loan-to-own strategy.

> *"So we do run things a bit differently here. It is a bit like credit bidding in the US. Credit bidding is normal, accepted practice for a distressed asset and its secured lender to come in. We do not get that down here, and why don't we get that down here is because we do not have the culture of the bank [being able to] buy the asset itself. Secured creditor comes in, tries to sell it to itself and it just does not come off because culturally people can't accept that. They want to see somebody independent come in and sure, okay, ultimately it might get sold to the secured creditor, but there's a process…there is an independent person who is not a puppet of the bank or the financier." (Cameron)*

Participants saw relevance for the use of the scheme of arrangement legislation to restructure very large insolvent companies, primarily because the insolvent-trading provisions were mitigated by greater access to liquidity, and thereby significantly reduced likelihood of liquidation.

> *"My perspective on that [588 provisions] is that the deeper the secondary debt market becomes and the more options for liquidity people have, the less likely the company will ever end up in liquidation. And therefore commercially the more comfortable all of the parties can be that trading-whilst-insolvent is no longer a factor. If you are confident that a restructure will ultimately occur and*

there is a viable business to be saved and salvaged out of a restructure, then I think it is less of an issue than if you are continuing to trade something with very low prospects." (Leslie)

Participants identified the potential for the transferability and expansion of this secondary debt market, and for it to generate liquidity and creative value realisation in the middle-market bilateral loan space, whilst acknowledging the distinct characteristics that posed challenges for expansion into this market.

"So I think definitely liquidity in the syndicated loan market has materially enhanced going-concern capacity of a number of stressed corporations. How can you create loan liquidity in the bilateral space? Because I think that would likely lead to the same outcome: very engaged people picking up bilateral loans and being less constrained around what a bank should or shouldn't do in a certain culture or business environment, trying to maximise value. I think the reasons banks find it more difficult to sell in a bilateral space has got to do with bank relationship issues as opposed to anything to do with regulatory regimes. Then there is the challenge of funds getting the visibility to put an offer on the table…[that]becomes more difficult, I think to do that deal without finding some process that validates the trade price. So you almost need a three-way [cooperation] between the bank, [the] borrower and the acquirer, with the borrower's consent presumably." (Dale)

This has facilitated the ability for traditional banks and financiers who would prefer to

pursue a conventional exit the ability to "trade out" and pass the debt to specialist debt traders.

> *"I think what's helped [a rescue culture] happen a bit is the attraction of hedge funds into the market and the secondary debt trading, and people running loan-to-own strategies. I think that people have seen that there is liquidity, so people who don't have that culture, who just want out on a certain file, they can hit a bid and get out. And the guy who is buying in does have the culture because he has bought in deliberately to do it, and that's helped a lot." (Philip)*

Schemes of Arrangements

Participants questioned the extent to which the scheme of arrangement legislation plays a role in restructuring distressed companies, and viewed the re-emergence of this process as more about pursuing the specific agenda of hedge funds or debt traders.

> *"The [scheme of arrangement legislation] seems to be mainly around trying to force an issue at the end of the day, whether it be via a hedge fund's loan-to-own strategy or what have you. The process takes a long time to get to that restructure point, and it is a very expensive, drawn-out process, which I think really only lends itself to an insolvency scenario where it is apparent pretty early on that equity is under water and the lenders are calling the shots. But the reason that they're going back to that is because [of] the surgical ability that it offers, debt-for-equity swaps and all those sorts of things." (Lee)*

In that regard, the Part 5.1 scheme process was seen as having very little applicability to a typical insolvent company trying to restructure. Instead, schemes of arrangement provided a mechanism to facilitate back-door acquisitions and enable well-resourced third parties to pursue their own objectives of achieving leveraged returns on discounted distressed debt purchased on the secondary debt market.

> *"You need to have the patience and have the funds to execute a [scheme of arrangement] strategy. It is an interesting combination of patience, being well funded and having a pretty sophisticated tool kit, in terms of being able to financially analyse the situation to make sure it is actually worth doing. You need some pretty experienced advisors, too, because you are talking about getting into some pretty technical areas where you want experience." (Adrian)*

> *"I think it's driven a fair bit by the hedge funds and the distressed secondary debt market trade. You've got people coming in buying up debt from lenders with loan-to-own purposes, and they've got a far more flexible view of the outcomes. They have got flexible capital; banks don't usually want to end up buying companies, which is not their desired outcome. Whereas hedge funds come in with that exact purpose: it's a back-door way of acquiring the company. So one of the few ways you can do that is through a scheme of arrangement." (Philip)*

Participants also identified that the extended time period required to successfully complete a scheme was a further deterrent to the process being used as a traditional

restructuring tool, given the time-criticality for most distressed companies.

> *"It is a pretty tough process. I mean if you want to do a debt-for-equity swap, which is what a lot of the distressed debt investors are looking for, you have got two schemes. Typically you are going to have the shareholders and creditors schemes, and you've got the court process to run in parallel with that. In our experience, getting to the point where stakeholders are on board with agreeing [to] a structure to put a scheme in place takes a long time, and with the court timetable the scheme itself takes many, many months. You have got to balance that against the need to protect peoples' interests and make sure they aren't unfairly prejudiced by those sorts of processes, but it does seem to be a slow, expensive process. So it does rule that out as an option for 99% of distressed transactions, I think." (Leslie)*

Participants reported that the challenge to achieving a successful outcome under a scheme of arrangement included the involvement and oversight of the court in the restructuring process. Court involvement reportedly not only resulted in increased time and cost, but also greater outcome uncertainty.

> *"We recently did a scheme of arrangement, a members and creditors scheme, and that was a successful restructure. But it was very hard to get in place, very expensive, and it's a process which has got a lot of steps to it where you don't have much control of outcomes in getting court approvals. So maybe that is an appropriate check and balance to what went on there: it was a debt-for-equity*

swap that was very successful for the hedge funds who bought into the debt there, with the equity changing into the hands of the lenders." (John)

One of the key benefits to this court involvement was reportedly the ability to bind classes of non-complying members to the arrangement by court order.

"There are a couple of structural advantages that attach to schemes of arrangement from a compliance-cost point of view. But it also becomes relevant now because if you have got a large syndicate you can scheme a non-complying member of the syndicate and a particular asset class, and you might have forty stakeholders and you don't want one to hold out as objecting to a particular strategy…so a scheme can bring those guys to the table." (Dale)

Additionally, the significant cost associated with bringing together a successful scheme of arrangement restricted the applicability of the regime to only the largest distressed companies.

"What struck me was that it was really only a viable option given the size of the deal – a smaller deal would be very hard to effect that sort of restructure. Most recently I worked on a big matter, $800 million worth of debt, senior and mezzanine, and that justified the process and expense. But I think that for a smaller work-out it would not be a very viable option. It was a few million in legal fees alone. So I think it's top-end stuff. Because it's not cheap to do a scheme and it's a big process for sure." (John)

Participants noted, however, that as more people became experienced and familiar with the scheme process and precedents begin to emerge, there was potential for this framework to have some further applicability to the medium to large market segment.

> *"There is talk that [schemes of arrangement] are going to migrate further down the market. So maybe they will start to look at trading those exposures, and we will see the hedge funds come in and get creative with those…because the last few we have done have been breaking new ground, certainly in our experience. I mean these things have happened, but not many people have seen them. I think that as more people get familiar with the concepts and how you go about it and the outcomes you can get, you might see the process get much more efficiently executed in terms of people going, 'Okay, we know how to achieve this,' getting everyone on board to support that outcome and execute to become a bit more efficient. Then maybe it will lend itself further down the market." (Dale)*

This section has discussed the re-emergence of schemes of arrangement related to hedge funds and distressed-debt traders participating in the secondary debt market, seeking to use the tool to pursue specific objectives, particularly a loan-to-own strategy. Participants reported that schemes of arrangement had very limited application to rehabilitating traditional insolvent companies, with relevance limited to very large companies due to the duration, cost and uncertainty of the process resulting from significant court involvement. The findings noted however, that the applicability of

schemes had the potential to increase as people became more familiar and experienced with the process, in turn lowering the costs and improving certainty.

CONCLUSION

This chapter presented findings surrounding perceived legislative and practical barriers to restructure, which included themes such as *ipso facto* clauses and the underlying viability of a business, and identified the impact in practice and, where appropriate, alternatives to address such barriers within the insolvency framework. It then examined the cultural considerations surrounding the operation of the Part 5.3A framework, including a focus on accountability and blame, the role of industrial relations policy and identified initiatives for a transition towards a corporate-rescue culture. The next chapter will discuss the meaning and relevance of these findings for the practice and policies of corporate restructuring in Australia.

CHAPTER 6: Discussion

INTRODUCTION

The present research sought to identify the perspectives of insolvency experts on the ways Australian companies are currently being rehabilitated, with a focus on the Part 5.3A voluntary-administration legislation. The specific research questions were:-

1) How do insolvency practitioners in Australia perceive the Part 5.3A legislation, and what are their views on its effectiveness?
2) What factors account for the relative decrease in voluntary-administration as a means of handling insolvent companies?
3) What are the barriers in practice to the effective rehabilitation of insolvent Australian companies as a matter of course?
4) How can we improve the mechanisms and effectiveness for insolvent companies to be restored to financial health, and what value might this have for a reconsideration of the Australian framework?

These research questions were answered using a qualitative methodology that thematically analysed the data from semi-structured interviews. Such a methodological approach allowed for the capturing of rich contextual information from experts in the field. Further, participants came from varied perspectives on the topic, including voluntary-administration, liquidation, receivership, bankruptcy, advisory and the practice of insolvency and bankruptcy law.

The extent to which a company can be successfully restructured has important implications for the economy, and the findings have shed light on potential ways in which the health of the Australian economy could be better guarded through insolvency practice. The present research has shown that there are a number of important ways in which the current insolvency framework affects the restructuring of Australian companies.

This chapter will discuss the legislative objectives and operation of the Part 5.3A legislation, outline what happens when a company gets into trouble, review the legislative and practical barriers to restructuring and identify the impact of cultural considerations on the Australian insolvency framework. The chapter will then consider the findings surrounding a transition to a corporate-rescue culture and the research recommendations to facilitate structural and legislative improvements to the existing framework for improved insolvency and corporate-rehabilitation outcomes.

OPERATION OF THE PART 5.3A FRAMEWORK

To gain an understanding of the effectiveness of the Part 5.3A legislation, one must first examine the key objectives that underpin the framework. The objectives are to rehabilitate the company, or as much of the business as possible, followed by a better return to creditors. Findings from the present research questioned the primary objective of the Part 5.3A legislation to pursue the rehabilitation of the corporate entity itself, and in particular the appropriateness of equity recapitalising primarily by way of compromise of creditor claims. This was argued as being inconsistent with the hierarchy of risks and rewards borne by stakeholders in the economy, particularly for the

rehabilitation of an insolvent company, which, by definition, often no longer possessed equity value. In practice, however, and consistent with Anderson (2001), the present findings concluded that because of the role of creditor participation in determining the administration outcome, this ensured an overriding focus on achieving the best likely creditor returns. This practice was the subject of criticism outlined in the literature (e.g., Broude, 2003), where concerns were highlighted that this default position failed to prioritise the objective to rehabilitate the insolvent company itself under such creditor-driven process, without due regard for other stakeholders. The present research adds to this, with acknowledgement that such creditor focus was often short-term, with a preference for conversion to cash, rather than for flexibility to pursue longer-term realisations to maximise the quantum of return, such as an extended deed of company arrangement or a converted equity interest. This, in turn, relegates the likelihood of the company itself being rehabilitated, and with it, the resultant total economic loss for equity holders, who range from small-business owners through to institutional investors on behalf of "mum and dad" investors and self-funded retirees.

Significantly, however, participants also reported a transition to growing commerciality in creditor behaviour, proactivity and appetite for alternative restructure proposals in the Australian market. This shift was driven by increasing recognition of the potential for ongoing relationships and trade, greater understanding of the insolvency process and outcomes and sympathy for the debtor's predicament. The implications for this shift in creditor behaviour, however, did not extend to the recognition of the value of broader community and knowledge/innovation considerations, which Merrett (2003) advocated should not be underestimated.

The research findings support empirical evidence that a very low number of companies successfully rehabilitate and emerge from the voluntary-administration process (Routledge, 1998), with anecdotal evidence from participants suggesting this rate could be as low as 5%. However, the findings also suggested that these statistics did not support criticism of the framework's effectiveness; instead, they supported a broader definition of rehabilitation that incorporated the survival of the underlying business together with improved creditor returns. Such a definition was postulated to reflect an improved statistical success rate. Participants flagged a misguided public perception of the relevance of the final fate of the corporate shell to the achievement of these outcomes, and raised concerns surrounding the failure to recognise the benefits achieved through the voluntary-administration process. Where companies entering voluntary-administration were unsuccessful in achieving improved stakeholder outcomes, participants agreed that there was a need for improved filtering of companies entering into external administration. Similar to Bickerdyke and Ors (2000), the present research highlighted the need for effective screening and appointment advice in selecting the appropriate insolvency procedure from the outset. This was regarded as important for not only the efficient use of the Part 5.3A process, but also management of the costs of insolvency.

Despite the insolvency statistics in Australia over the past decade indicating a doubling of companies entering into some form of formal appointment (ASIC, 2014), a review of official statistics revealed a significant decrease in the relative popularity of the voluntary-administration process (ASIC, 2014). The present findings identified that a

distortive impact on the statistical decline in the popularity of Part 5.3A was legislative efforts to address historical levels of unmeritorious use of the process as a default or gateway appointment, facilitated by its relative simplicity of commencement (Anderson, 2001). The findings indicate that this issue was substantially addressed by the 2007 amendments improving the ease with which insolvent companies without prospect of rehabilitation could directly pursue the creditors' voluntary-liquidation process; this is consistent with the subsequent decline in the popularity of voluntary-administration in the ASIC statistics. The present findings also tell us that in particular, the effective appointment selection between voluntary-administration and creditors' voluntary liquidation is essential for smaller companies, where most failures occur and volume is highest. Participants felt this was critical for the efficient operation of the Australian insolvency framework, due to these businesses' minimal assets and likelihood of sustaining a successful restructure, and thereby facilitating further improvement in the success rate. Participants attributed a significant proportion of the growth in insolvency statistics since the turn of the century to the increasing prevalence of small personal-service and phoenix-type companies. This, in turn, had implications for understanding the declining rates in the use of the voluntary-administration process relative to such growth in corporate-insolvency volume. In addition to this structural shift in legislation, participants also flagged a perception of voluntary-administration as a terminal process tainted by the potential of damage to reputation and media negativity, as previously discussed by Hale (1999).

CORPORATE DISTRESS AND THE REHABILITATION PROCESS

This section will discuss the importance of formal appointment timing for a company approaching insolvency, the valuable role of greater outcome planning to pursue improved outcomes and consider the implications surrounding informal restructuring. The present findings were consistent with Milman et al. (2004), which highlighted the role of appointment timing and preparation as determinants to the likelihood of success for companies entering into voluntary-administration. These were shown to be key drivers of the low success rate of companies rehabilitating. This was attributed to the ongoing erosion of equity and depletion of previously available external capital, which, if injected in conjunction with a well thought out restructure plan, was found to materially increase the likelihood of success. Similar to Frisby (2004), the present research identified that timely appointment of an external administrator could ensure that the underlying company had not reached the point of distress where it was unable to endure the strains of formal restructure, both from an operational viewpoint and a stage of diminished stakeholder support. The findings identified that for earlier appointment to occur, there needed to be a change in company director's perception that voluntary-administration was a terminal process with a highly uncertain upside, particularly for shareholders of the company. This finding was part of a broader one outlined later in this chapter that highlighted the imperative need for improved director education, including surrounding the insolvency and restructuring process.

The role of planning and a pre-defined strategy to rehabilitate the company prior to the appointment of an administrator - with the availability of fresh capital and support of

the company's banker - were identified as key in mitigating uncertainty and the likelihood of a negative outcome. This planning had implications for the development of concepts such as the pre-packaging of deeds of company arrangement or asset sale plans. These implications primarily related to meeting the tight statutory timelines the process required. Participants recognised in principle the potential for greater appointment preparation and pre-pack type arrangements as a tool to preserve the underlying business and assets, minimising the value destruction associated with a prolonged formal administration process. This concept under a deed of company arrangement format was also recognised as having the ability to preserve value for existing shareholders by providing an improved likelihood of meeting the tight statutory timeframes and realising stakeholder support. Similar to Walton and Wellard (2012), the findings identified the potential for improved preservation of such business and asset value, either through a related party pre-pack or a third-party sale, with corresponding improved outcomes for all stakeholders.

However, findings suggest that pre-pack restructurings in Australia were not prevalent in practice, and whilst acknowledging that they were possible, and potentially provided timely outcomes to corporate restructuring (as suggested by Lloyd, O'Brien and Robertson, 2009), they had not received acceptance in the Australian market. This lack of acceptance was largely attributed to an inherent conflict of pre-pack arrangements with the underlying Australian procedural principles of independence and objectivity of the administrator. The findings were clear that given these issues of administrator independence and objectivity, market-value realisation and cultural expectations, there

were significant challenges to replicating the success of the UK model of pre-packs in an Australian context without a clear legislative mandate.

Whilst the timing of a distressed company seeking formal external assistance was a determinant of successful restructuring (Milman, 2004), timing also had implications for the operation and effectiveness of the company's informal restructuring. This was particularly relevant given the reported increase in trends towards more informal mechanisms in Australia to facilitate restructure and work through liquidity issues, outside the spotlight of external administration. Whilst the basic premise of voluntary-administration focus on addressing the looming prospect of insolvency, findings indicated that Australian companies viewed the process with fear, in contrast to jurisdictions such as the US where entering Chapter 11 was the first step to accomplishing a rehabilitation. Participants identified the benefits of timely and well-structured reorganisation as a valuable tool to minimise enterprise-value destruction, consistent with the findings of Hahn (2004). The present research further highlighted that distressed companies that pursued informal rehabilitation also had the potential to benefit from greater creativity and flexibility and lower costs. The value of such an informal work-out for a distressed company was particularly evident where they held significant intangible assets or were exposed to contracts containing *ipso facto* clauses, or where customers were sensitive to counterparty risk. However, findings relating to this preference for informal restructuring also brought with it the challenge of focusing stakeholders on the risk of insolvency and failure to recognise the need to transition to external administration where required, due to directors' underlying reluctance to cede control. Findings suggest this increases risk and incites value destruction, which

informal rehabilitation seeks to avoid, with the additional potential consequences of freefall unplanned insolvency.

INSOLVENT TRADING PROVISIONS AND RESTRUCTURE

Despite the extensive criticism of the s 588G insolvent trading provisions in the literature, and complexity surrounding the conflict of interest in directors avoiding personal liability versus their duty to the company and stakeholders (D'Angelo, 2006), the findings were generally supportive of the provisions operation and policy objectives. There was majority consensus that whilst the deterrence presented by insolvent-trading provisions did potentially create a misalignment between directors and the interests of company shareholders - particularly for public companies - this was seen as an appropriate balance for the protection of broader stakeholders. Significantly, findings did not support assertions that the legislation caused directors to become unduly adverse to risk (James, Ramsay and Siva, 2004), with the framing of improved legal advice to directors on their insolvent-trading obligations providing assistance in this regard. The findings also reported that the balance in practice between the provision's deterrent effect, as contrasted with the level of prosecutions for insolvent trading, provided an appropriate context to ensure that directors exercised the requisite level of professional judgement, proactivity and responsibility. There was recognition that the policy value of the insolvent-trading objectives were worth pursuing in relation to directors' propriety, conduct and obligations under the Corporations Act and at common law. However, participants acknowledged the need to improve the operation of the s 588G legislation to accommodate the trend towards informal rehabilitation.

As suggested by Robinson (2009), this was particularly the case where bona fide restructuring was being pursued. Participants identified the potential for a greater role for a company's directors, who were often well placed to exercise their skill and commercial acumen to facilitate a successful corporate restructure. This in turn had implications for improved informal corporate rehabilitation mechanisms to address the risk of insolvent-trading liability and encourage competent directors to remain engaged in the process and contribute to the solution. The present findings suggest that legislators had missed an opportunity (Safe Harbour, 2010) to evolve legislation that would have addressed these insolvent-trading issues, including the two proposed alternatives of a business-judgement rule or a moratorium on insolvent trading. In conjunction with such changes for greater flexibility, the findings advocated for greater impetus for directors of distressed companies to seek and consider professional assistance in pursuit of an informal restructure. With the emergence of turnaround specialists there has come a need for greater protection of such advisors from exposure to prosecution for insolvent trading as a shadow director in a work-out process (Routledge & McNamara, 2005), which the current research supports. One potential solution advocated in the findings was the introduction of a chief restructuring officer, to ensure company directors maintained a responsible level of risk engagement and conduct whilst maintaining flexibility in the informal work-out framework.

The establishment of a chief restructuring officer in an informal rehabilitation as discussed in the literature by Sloan (2008b), was supported in the findings as a third option to mitigating the issues and risks surrounding insolvent trading. In the context of this research, only the chief restructuring officer role would have insolvent-trading

immunity, with the expectation that such an appointment would help company directors proactively monitor the ongoing issue of insolvency and focus resources on the rehabilitation process itself. Whilst such engagement would not provide direct safe-harbour protection for directors during a work-out, the present research suggested that this legislative change would provide additional protection in conjunction with the existing defences and statutory mechanisms to excuse a director from insolvent-trading liability. Participants emphasised, however, the importance of such a mandate for a chief restructuring officer including the requirement of a demonstrated nexus between the advice provided by the chief restructuring officer and the board's actions. This would ensure that the chief restructuring officer would be able to exercise their expertise, knowledge and commercial judgement to provide leadership and guide the rehabilitation of the distressed company at the board level whilst monitoring the ongoing insolvency position. The findings suggested that this would strike the right balance between the benefits of informal rehabilitation, with the need for control and oversight to ensure the interests of all stakeholders were protected. However, the findings indicated the need for caution surrounding the chief restructuring officer role, given this shield from insolvent trading, suggesting that the chief restructuring officer should be licensed and under strict supervision of the regulators. Whilst acknowledging the potential for self-interest, participants felt that registered or official liquidators would be best placed to undertake this role; they noted, however, that such an appointment would subsequently conflict out that practitioner from being appointed as a voluntary-administrator.

LEGISLATIVE FRAMEWORK AND RESTRUCTURING

This section will discuss the key barriers that the Part 5.3A legislation was shown to exercise over the effective rehabilitation of insolvent Australian companies. These barriers included the issue of moratorium protection from *ipso facto* clauses, the impact of administrator trading-liability provisions, Part 5.3A framework scalability for company size and the legislative potential for administrators to seek greater court direction and guidance.

Ipso Facto Clauses

The present findings reinforced the need for greater protection around *ipso facto* clauses and the catastrophic results from voiding of contracts (Parbery, 2008), with unanimous consensus on this issue being one of the most fundamental and urgent barriers under the voluntary-administration framework requiring attention. Participants identified the absence of such protections as a key inconsistency with restructuring legislation overseas, including in the US and UK, and the lack of attention by legislators was stated as a key source of frustration for practitioners. The findings reported that the exercise of *ipso facto* clauses was a key deterrent for distressed companies using the voluntary-administration process, particularly where key contracts would be jeopardised. Such value destruction was identified as counterintuitive to the objectives of the Part 5.3A legislation, which participants advocated could be addressed by extending moratorium protection to the enforcement of *ipso facto* clauses. The findings indicated that the extension of the moratorium to *ipso facto* clauses would not unreasonably interfere with the rights of contracted counterparties. Whilst rights to terminate would be suspended during such a period, the requirement for ongoing contractual obligations and payments to be met as specified under the contract would remain. The findings recognised the

need for balancing such policy considerations with the question of whether contracting parties should be required to honour contracts with insolvent companies seeking external administration. In that regard, *ipso facto* clauses were viewed as a sub-set of landlord or leasehold interests, which were subject to a temporary suspension of rights under a moratorium, rather than a reconstruction of the contractual relationship itself.

This approach had implications for an inability to compel counterparties to maintain ongoing contractual relationships post-moratorium, when the right to terminate would resume; thus remaining consistent with the greater policy consideration of ensuring freedom of contract between parties. This approach was found to provide the right balance between the need to protect the interests of stakeholders in an insolvent company, and a recognition of the long-held policy position that “the courts have not sought a power to destroy the rights and obligations which the parties to a contract create” (Stern v McArthur (1988) 165 CLR 489, Brennan J at 514). The findings suggested that this extension of the voluntary-administration moratorium would increase companies’ use of the process, due to the attractiveness of broader statutory protections compared to an informal restructure.

Administrator Trading Risk Exposure

Another issue identified in the findings related to administrator trading risk exposure as a barrier to effective restructure under Part 5.3A, with the research supporting existing literature that the threat of personal liability did create an inherent conservative bias in the decision-making and restructuring process (Frisby, 2004). Significantly, findings suggested that this higher burden played a critical role under the legislation to achieve

conservative judgement, which helped the insolvency framework to work equitably and consistent with the need for safeguards advocated by Fridman (2003). The present research found that the administrator trading risk exposure led to practitioners focusing on improved creative thinking to achieve trading and operational outcomes. Facilitating such creative thinking to successfully achieve ongoing trading was identified as pivotal to promoting restructuring outcomes whilst minimising the risk of ongoing creditor value destruction.

The findings, however, identified specific challenges around planning and the issue of administrator conflict and independence leading up to appointment. These challenges were a key inhibitor of efficient post-appointment trading and restructure. Particularly for more complex restructures, this was highlighted as exposing practitioners to unnecessary trading-exposure risk, and resulted in the need for significant day-to-day focus on monitoring the company's cashflow and trading operational position. Such oversight had the impact of often requiring significant administrator staffing. This was contrasted to the execution of a well-planned restructure, which had the potential to include the implementation of controls and structures that could delegate these operating activities to existing management and significantly enhance an administrator's ability to focus on implementing the company's restructure plan and undertake the strategic role of the executive. Consistent with research outlined by Poulos and McCunn (2011), the findings suggested that it was in this area of pre-appointment planning that most efficiency gains could be achieved. This was highlighted as preferable to alternatives such as the reduction of trading-risk exposure, which participants felt provided an important incentive for administrators to balance both sides of the ledger.

Senior-Lender Enforcement

Previous literature has suggested that the absence of a moratorium or protection under the legislation surrounding senior-lender enforcement was a barrier to restructuring (Merrett, 2003). The present research, however, did not support the need for such a moratorium. Participants reported that there had been improvements in the relationships and integration between bankers and insolvency practitioners, with an improved underlying focus on restructuring companies as a going concern. This had formed the basis for a cultural shift whereby senior lenders recognised value and demonstrated greater awareness of the need to work constructively with distressed companies with a view to restructure. These findings were also in contrast to research undertaken by Fridman (2003), which flagged the barrier of senior lenders enforcing security precipitously to frustrate rehabilitation. Where directors sought formal mechanisms to restructure, such as voluntary-administration, the likelihood of secured creditors seeking the appointment of receivers to protect their own interests was increasingly seen as unusual. This approach was particularly apparent where senior creditors felt their security rights were well protected and would not be prejudiced by pursuing restructure outcomes under VA. Subject to emphasising the need for strong communication and transparency with the senior lenders throughout the restructuring process, participants recognised a growing emphasis on brand protection of senior lenders in the market as a contributing rationale for this trend.

The findings did not support the adoption in Australia of measures in other overseas jurisdictions for a moratorium on senior-creditor enforcement, to replace the current

ability to enforce their charge within an extendable "decision period" of 10 days from the administrator's appointment. Instead, the research suggested that such restrictions on senior-lender rights had the potential to inhibit the Australian rehabilitation framework by encouraging banks to formally appoint earlier upon identifying distress. An explanation for the extent of this conflict between the literature and the present findings includes the potential for practitioner bias against legislating to constrain secured creditor rights raised by Davies (2002), given the reality that insolvency practitioners often depend on banks for repeat insolvency work. Participants also identified the ongoing importance for a company pursuing restructure of gaining the support and cooperation of their secured lenders to achieve a successful and sustainable outcome. Without such senior-lender support, and even with moratorium protection to prevent enforcement, the findings concluded that a company with an unsupportive senior lender would likely fail through the rehabilitation process, particularly once the moratorium came to an end. This was consistent with the findings of Day and Taylor (2001), who acknowledged that the need for ongoing funding by senior lenders post-restructure resulted in their considerable influence in ensuring this transition occurred under acceptable terms.

One fundamental shift in senior-lender behaviour outlined in the findings related to the newfound willingness of traditional lenders to sell down distressed debt into the secondary debt market, often at below par. The emergence of this secondary debt market - primarily consisting of hedge funds and alternative debt traders - provided an alternative exit scenario for these mainstream lenders and has seen a transition in how distress is handled and the form restructure takes. This willingness for mainstream

banks to accept a compromise that better reflects mark-to-market value has brought into play the differing perspectives and objectives of these secondary debt traders. Participants observed that often such debt traders had brought to the table more flexible views of rehabilitation outcomes, ranging from the pursuit of loan-to-own strategies to innovative debt restructures or other forms of impairment mitigation. The emergence of this secondary debt market was also identified as the catalyst for the re-emergence of the largely redundant scheme of arrangement provisions. However, the pursuit of alternative and non-conventional restructuring, including the pursuit of debt-for-equity swaps and potential for creditor class cram-down using the scheme of arrangement framework, have largely been restricted to very large companies due to the prohibitive costs of this court-driven process. The findings also identified broader implications of this secondary debt trading for a reconsideration of the role played by senior lenders operating in the mid-to-large company segment. In that regard, the findings outlined scope for the potential of this secondary debt market to provide grounds for a reconsideration for mid-market companies in distress, particularly as greater pricing transparency developed and the significant court costs relating to scheme of arrangements fell.

Framework Scalability and Company Size

The findings showed that in practice, the Part 5.3A legislation provided a scalable framework for the restructure of Australian companies across a broad spectrum, with further flexibility in the process achievable by application to the courts. Participants identified that the "sweet spot" in the Part 5.3A process was in the small to medium-

sized company segment, rather than the accommodation of larger-scale restructurings, where the research concurred with challenges identified elsewhere (Anderson, 2008). Whilst not representing the greatest number of restructures, the large corporate segment was identified as of critical importance due to the impact of the failure of large companies upon the economy. It became apparent from the findings that practitioners in this larger segment found the prescriptive timeframes under Part 5.3A unrealistic, with the resultant ongoing need to seek court approval costly and distracting to the restructuring process. Participants stated that for these very large companies, with anecdotal reference to debt restructures exceeding $100 million, practitioners experienced a transition from the operation of the Part 5.3A process as a dynamic restructuring tool to a blunt and cumbersome one. To facilitate a rescue culture, it may then be best to place primacy on achieving rehabilitation and relegate the timing of investigation and accountability to a secondary position.

At the opposite end of the spectrum, in the case of very small distressed companies, the findings reported that the already-challenging need to recapitalise their balance sheet and restructure was further complicated by costs disproportionate to their size, which made the VA process prohibitive. At this very small end, the findings queried the scope of work required under Part 5.3A and the extent of value really added by such procedures. Instead, the findings advocated a reconsideration of the "one size fits all" approach under Part 5.3A. Participants made two alternative recommendations to address the issue of company size in the framework: consideration of a split-process framework, or refinements to the existing Part 5.3A framework to reflect a focus on medium-sized to larger companies, with additional guidance on scope-of-work

requirements for very small companies. Findings suggest the economic significance of an effective framework for the larger corporate segment, emphasising that a realignment of focus under Part 5.3A to accommodate complexity and scale was considered critical. Given this hierarchy of needs, participants expressed preference for refinements to the Part 5.3A framework to better align with the requirements of larger-scale restructurings, whilst achieving ongoing relevance to small-company restructurings by including scale-back guidance in policy objectives.

Court Direction and Guidance

It has been established that an effective feature of the design and operation of the Part 5.3A framework has been its ability to minimise the need for court involvement and direction as a matter of course (Collins, 2004). This study's participants agreed that the current Part 5.3A design was effective in streamlining the cost and efficiency of the procedure in practice. However, the present findings identified wide-ranging scope for invoking the court's supervisory role during the procedure to overcome barriers to restructuring in need. Through existing legislative provisions, the research supported the interpreted scope under s 447A as providing the courts with a valuable tool to facilitate flexibility, thereby enabling administrators to seek court direction to facilitate bespoke restructure outcomes (Barrett, 2003). Whilst there was recognition that court engagement in some areas of the Part 5.3A process had been forthcoming, including moratorium periods and other timeframe/reporting extensions, the findings suggested greater scope for administrators to use these existing provisions to address broader restructuring barriers. Additionally, the present findings also suggested that provisions such as s 1317S of the Corporations Act, relating to the provision of relief from director liability for contravening civil-penalty provisions, provided proactive opportunities to

seek court direction on the applicability of insolvent-trading liability during an informal work-out. In particular, findings suggest that under s 1317S(4) an avenue exists for advisors to seek court relief for prospective immunity on the basis of a well-structured and feasible recovery plan, to address shadow director provisions outside the formal insolvency framework.

The findings identified further untested potential for greater judicial interaction and direction on more complicated or creative restructures, which would avoid administrators taking a default conservative position in discharging their delegated decision-making responsibilities. Inhibiting this potential for greater judicial involvement, however, was the established reluctance of the Australian judiciary to make decisions for administrators, particularly where commercial judgement was involved (Swain, 2003). Participants viewed this shortcoming as more structural than legislative, and flagged the potential for a specialist court to provide greater judicial support in facilitating improved non-conventional restructure outcomes. This would represent an important tool for administrators to not only challenge the status quo on restructure outcomes, but also provide the ability to pursue broader social considerations such as ongoing employment, community sustainability and environmental consideration. Findings thereby suggested the potential for improved restructure flexibility through taking advantage of existing legislative provisions for the exercise of judicial discretion, rather than the need for a wholesale transition to a US Chapter 11-style framework.

UNDERLYING BUSINESS VIABILITY

This section will discuss the determinants and criticality of underlying business viability for successful restructuring and outline the importance of accurately identifying such viability for the effective operation of a rehabilitation framework. It will then consider the impact of issues such as quality of directors, poor books and records and reporting systems and the priority and quantum of employee entitlements, on a viable businesses' ability to restructure.

It is firmly established that an effective insolvency framework and operation of the Part 5.3A framework needs an underlying viable business (White, 1994), which the current research supports. Participants pointed out that the assessment and identification of a viable business was critical early in the VA process to safeguard the prospects of salvation and as an early predictor of success. They reported that this assessment needed to include both the underlying financial and operating positions and, in particular, the sustainability of cash flow. For rehabilitation to be successful using the existing corporate structure, the presence of a viable business was also required to overcome the hurdle of securing balance-sheet recapitalisation. The findings showed that the effectiveness of the Part 5.3A framework outside a "sale of business" outcome was primarily contingent on recapitalisation through the injection of equity, creditor-claim compromise, delayed realisation of creditor claims or a combination of these. Again, the absence of *ipso facto* clause protection within the framework appeared as a key issue, as identified in the literature (Eyers, 2009). In conjunction with the potential catastrophic value destruction these terminations can inflict on business viability, the findings highlighted the equally significant challenges posed by the total absence of long-term

counterparty contracts, representing an inherent weakness of the business. The findings highlighted the minimal underlying value associated with businesses underpinned by such contractual arrangements from inception, which render them unlikely to benefit from any restructuring framework. It is thus essential to consider the viability of a business at the outset, before pursuing any rehabilitation process.

The findings identified that key characteristics of a business likely to sustain rehabilitation under Part 5.3A included clear market position and significance, strong management and relevance to its customers. Anecdotal evidence from the findings suggested that these characteristics were present in 20-25% of businesses entering into the framework, providing the potential to survive the strains of insolvency. Even where there was no potential for a corporate entity to be salvaged, the identification of a viable business (or segments of a business) provided an opportunity under VA to run a sale process for the business as a whole or in part, to maximise creditors' realisations. The findings also highlighted the recent trend for very large distressed companies with strong viable businesses undermined by structural factors, such as overly high gearing levels, to engage the scheme of arrangement legislation to rehabilitate and avoid formal insolvency. However, this had limited application in the majority of rehabilitation efforts to salvage distressed businesses, given the onerously high costs and extended timeframe requirements, making it a realistic option for only the very largest Australian companies.

The findings confirmed that the quality of directors is a key determinant of early intervention and the commencement of an action plan to address distress and

insolvency, as outlined by Finch (2002). This was identified in the current study as being related to a number of factors, including poor reporting and information, excessive reliance on management and inadequate understanding of the company's financial position, particularly relating to cash flow. Directors' conduct towards stakeholders was also flagged as an important determinant of the likelihood of a successful restructure. This included issues of honesty, proactive communication and the ongoing maintenance of trust with stakeholders, which the present research found was critical in securing support, particularly for marginal restructuring proposals. Significantly, the findings observed that most directors of insolvent companies did not seek to engage in deception or misleading conduct in their dealings with shareholders. Instead, failure for timely rehabilitation mainly resulted from the inability of directors to identify and acknowledge the extent and immediacy of distress. Particularly in smaller companies, the quality of director skill sets and awareness of their duties was experienced as inadequate, and this was often further compounded by an inability to separately deal with corporate and personal interests. To address this issue, higher thresholds and education levels for company directors were advocated, to improve awareness of these responsibilities and the financial consequences of their actions.

It became apparent from the present findings that poor books and records and reporting systems was far more widespread than suggested in the literature (e.g., Fernandez, 2002), representing a further systemic barrier to restructure. Practitioners reported that the records of insolvent companies were consistently incomplete and unreliable. The findings also reported that these barriers were not limited to smaller private companies, but transcended size, and were also evident in listed companies. These weaknesses in

reporting systems and poor record-keeping formed key barriers to the timely identification of distress and companies' ability to address insolvency and restructure. Poor financial reporting was also identified as responsible for critical decision-making on "gut instinct" by management and directors and a failure to genuinely understand the viability of business segments and overall financial performance. Participants highlighted the need to rethink the value of timely information and reporting to facilitate an understanding of business drivers and assess performance against KPIs and improved forecasting and budgets. Once a distressed company has undergone formal appointment, poor books and records and reporting systems significantly affected practitioners' ability to assess business viability in a timely manner. This was reported as a real threat to the likelihood of rehabilitation, not only with regard to the issues of ongoing trade, but also an administrator's ability to recommend a DOCA or execute a sale of business, as outlined by Routledge and Gadenne (2000). The findings also raised the need for greater auditor accountability and proactivity, with ongoing shortcomings identified around solvency and going concern in financial reporting and the quality of record-keeping of audited Australian companies. Improved record-keeping and reporting systems may therefore bring about not only an increased likelihood of insolvent companies rehabilitating, but also reduce the likelihood of viable companies becoming distressed in the first instance.

The findings on employee entitlements were consistent with the literature, with consensus amongst participants that the quantum and inability to compromise this class of creditors represented a key barrier to restructure (Sloan, 2008b). The findings advocated for flexibility in the treatment of legacy employee entitlements, with

viewpoints ranging from allowing cram-down of entitlements through to the ability to compromise priority where external funding was being injected to facilitate restructure. It became apparent, however, that participants felt that the ultimate decision to compromise employee entitlements or priority should reside with employees themselves. This provided these creditors with the opportunity to weigh up the benefits of ongoing employment following a compromise of their claims, with the risk of a rehabilitated company failing post-restructure. Significantly, the findings highlighted the underlying incentive that the introduction of the GEERS program had inadvertently created for the insolvent company to proceed to liquidation rather than restructure or achieve transition of entitlements through a business sale. This was a function of the crystallisation of employee entitlements and the guarantee of payments made under the GEERS safety net (Whelan & Zwier, 2005). The findings noted that with the ongoing creep in the quantum of employee entitlements, this creditor class now represented a major component of a company's liabilities. This had increasing implications for the restructuring process, which were further compounded by the reportedly common perception by employees that such employee entitlement funds had been misappropriated. Instead, participants reported in a majority of cases, the reality was that such funds were never available in the first instance. Furthermore, under a business sale or rehabilitation process, the transfer of employee entitlements in full as required under the existing legislation, simply represented the often untenable replication of this burden post-restructure.

CULTURAL CONSIDERATIONS FOR CORPORATE RESTRUCTURE

The present findings highlight the impact of culture on how the Part 5.3A legislation operates to facilitate corporate restructure, a notion underestimated in the literature. The findings contrasted this culture of corporate failure responsibility, accountability and blame, in the Australian context to other foreign jurisdictions such as the US and UK, which were perceived to have a more positive and constructive view of corporate work-out (Crutchfield, 2003). Participants highlighted the role of culture in reinforcing the stigma associated with formal restructuring in Australia, and the perception of failure and the damage to brand and reputation associated with voluntary-administration. This was found to extend not only to the insolvent company, but to directors and management. Previous research has shown this reputational impact and damage associated with corporate insolvency in Australia as facilitating an often self-fulfilling path to corporate collapse (Hale, 1999). The present research adds to this and identifies culture as a key driver underlying preferences to pursue restructure informally. Participants reported that this negativity surrounding formal insolvency was also a key factor behind the preference shift for senior lenders to exhaust all avenues of financial accommodation and flexibility prior to enforcement, including the recent trend to sell down high-profile distressed exposures in the secondary debt market. The findings reported that the manner in which insolvency was reported by the media and how those associated with insolvency were portrayed reflected the broader entrenched culture of blame within Australian society.

Furthermore, participants considered that the policy focus on investigation and accountability for corporate insolvency was responsible for the significant post-

appointment pressure on practitioners, who were simultaneously trying to keep the business alive. This focus on accountability under voluntary-administration made prosecution of directors and funds recovery from insolvent trading and unfair preferences more likely, which influenced whether liquidation or corporate rescue should be pursued. This culture was also identified to have permeated the attitudes and priorities of administrators, influenced by the focus of regulators on holding directors of insolvent companies accountable for failure. Participants highlighted the counterproductive impact of this perception of voluntary-administration, the stigma of failure and the broader enforcement focus, on directors pursuing a "business rescue" culture and pursuing timely appointment under Part 5.3A. This was identified as responsible for company directors perceiving VA as an "option of last resort" whereby formal appointment often coincided with directors abandoning their proactive pursuit of restructure. The present findings suggest that the ability of the VA legislation to operate as an effective regulatory mechanism is thereby constrained by the country and cultural framework (Hofstede et al., 2007), in conjunction with barriers created by legislative capability. In that regard, whilst such policy framework had been influenced by underlying cultural values in Australia, participants identified policy shift as a key mechanism for achieving an improved restructuring framework.

The present findings also suggest the important role of culture and social considerations in the issue of employee entitlements. Whilst acknowledging the negative impact of employee entitlements on the likelihood of restructure for Australian companies, participants clearly articulated the limited cultural appetite in Australia for change in this area. There was consensus that employee entitlements were sacrosanct, and that any

shift in policy that was inconsistent with this position would be politically untenable. This is underpinned by the Australian industrial-relations framework, which from a historical perspective has taken a fundamentally different approach to that in other jurisdictions. The strength of the trade-union movement and the political ideology that forms the foundation for the protection of this category of creditors suggest that a shift to a US-style cram-down of employee entitlements is unacceptable from a social viewpoint and highly unlikely to succeed. Where participants flagged concern and scope for improvement surrounding employee-entitlement policy was in relation to the application of initiatives under the GEERS program. Given that the findings highlighted a perceived underlying preference for employees to retain ongoing employment, participants identified an opportunity for improvements to the GEERS legislation to provide greater scope for safety-net entitlement support under a restructure scenario such as a DOCA. Findings highlight that the economic cost of expanding GEERS to assist in covering entitlements under a DOCA restructure has the potential to offset the economic and structural cost of unsustainable zombie companies re-emerging burdened with significant legacy entitlements, in addition to yielding valuable social outcomes. These potential social outcomes would go beyond ongoing employment to include sustainability of the employer and restored confidence in the company's viability from the perspective of employees, unions and their families.

TRANSITION TO A CORPORATE-RESCUE CULTURE

This section will discuss the benefits of pursuing a corporate rescue culture and the ways in which the findings suggest a corporate-rescue culture can be achieved. The findings highlighted that the focus of the Part 5.3A legislation has evolved into a

comparative exercise between executing a DOCA and liquidation, rather than facilitating corporate rescue as a matter of course where appropriate. This position was supported by the anecdotally low levels of successful DOCAs, and in particular fewer outcomes that had achieved a meaningful percentage return to creditors. Furthermore, participants reported that liquidation under the existing Australian legislation, rather than the development of rescue alternatives to the rejected proposed plan, had become the default position for creditors. There was support in the findings to address limitations of the Part 5.3A framework raised by Anderson (2008) in seeking specific alternatives for creditors to vote on a time extension to compile and consider a revised rehabilitation plan. The findings also recognised the need for an effective corporate-rescue framework for the Australian economy to perform throughout the economic cycle and avoid the systemic burden of non-performing companies treading water endlessly whilst experiencing distress. Such inefficient use of capital in the Australian economy was recognised as inhibiting growth and productivity, given the existing capital constraints. In that regard, findings identified the sustainability of corporate restructure that was contingent on an appropriate capital restructure as the foundation to any operational turnaround. Furthermore, the criticality of a culture of director recognition for using the framework in a timely manner (Fridman, 2003), and a broader responsibility to stakeholders to pursue opportunities for restructure was seen as a further key ingredient. Achievement of the latter was seen as contingent on addressing the negative perceptions, and revising prosecution-driven policies around accountability for corporate failure and insolvent trading being the impetus for formal appointment (Sloan, 2008b). Participants favoured a proactive approach to engaging directors and

realising the commercial rationale behind applying the Part 5.3A voluntary-administration framework for corporate rescue.

Findings did not support a wholesale transition towards a US Chapter 11-style framework, despite acknowledgement in the literature that this framework was regarded as an effective debtor-friendly restructuring tool (Lewis, 2001) particularly for large companies. Whilst the present research recognised the value of elements of an alternative DIP model, the benefits were outweighed by significant risks. Such risks included ongoing losses and erosion of available assets in the hands of the debtor and the burden of significant costs associated with the requisite advisor and court oversight. In the Australian context, participants highlighted challenges in continuing supply whilst freezing creditor accounts, with the debtor remaining in possession and the existing management team in control. Instead, the findings advocated for the retention and development of the PIP model which benefited from the suspension of director control acting as a catalyst for an independent practitioner to objectively assess and pursue the most appropriate outcome. It was beyond the scope of the present research to consider the degree to which support for this model was unanimous outside of the research sample. Given the range of operational, industry and board-level factors and the associated resources required for administrators to get their minds across companies in a very short period of time, merit was recognised for the improved utilisation of management in situ. Particularly for larger, more complex companies, the findings identified the potential for operational change, where appropriate and within a control framework. This would more effectively use existing management and other innovative mechanisms such as engaging third parties to run businesses under license to capture the

potential benefits under a DIP model (Westbrook, 2004). This, in turn, was recognised to have the potential to address a number of challenges associated with the PIP model, and enable practitioners to focus on the strategic and cost-efficient restructure and rehabilitation of the company.

The findings did not support assertions in the literature that practitioners' approach to insolvency, including the preservation of assets and creditor return maximisation (Agardy, 2002) resulted in a default liquidation bias. Instead, the findings depict the VA process as an effective mechanism for protecting an insolvent company with tools best placed to execute a rescue outcome. Participants in this study identified the lack of credibility around the VA process in part as reflecting perceived high practitioner costs, poor communication of fee structure and unrealistic practitioner advice around outcomes, often driven by industry competitiveness. This had increasingly seen the commoditisation of the insolvency industry, compounded by directors' attempts to "shop the job" on price of voluntary-administration, rather than seeking to identify the appropriate skill set and strategic approach required. The present findings identified that whilst legislative changes in 2007 around the insolvency framework had facilitated a sharp decline in unmeritorious use of VA, ongoing ease of access warranted further review given the high economic cost to achieve greater efficiency in the insolvency process. The findings also identified concerns in the trend to informal insolvency following the failure of the recent Safe Harbour (2010) initiatives to gain traction and facilitate ongoing improvement. The findings highlighted the role of the political environment in determining the appetite for legislative change, given the criticality of

improving efficiencies in the economy that are affected by the distress base of Australian corporates.

Secondary Distressed Debt Market

An evolving trend highlighted in the present research was the development of the secondary distressed debt market over the last few years for very large companies. Concurrent with this was the reported re-emergence of the scheme of arrangement provisions. The potential for scheme of arrangement legislation to facilitate restructures such as debt-to-equity swaps has opened the door to a new class of investors, such as hedge funds and distressed debt funds, to invest money into a distressed company. Whilst this legislation was not specifically targeted at insolvent companies and does not provide protection from the s 588G insolvent trading provisions, this exposure is often mitigated by greater access to liquidity through the debt acquirer. The issues surrounding shadow-director liability of third parties, including bankers (Brown, 2009), were considered to have limited application in the findings, further assisted by the strong likelihood of rehabilitation. Although at present this distressed-debt market represents a tiny portion of distressed corporate debt, with a strong high-end focus on companies with significant market positions hampered by over-leveraged balance sheets, participants identified that the deepening of the secondary debt market could offer improved opportunities for debt liquidity. The findings further raised implications for the currently untested expansion of this secondary debt market to extend liquidity into the mid-large size loan market segment. Together with a mindset change by banks, which were often concerned about damaging the direct customer relationships in this segment as opposed to the larger syndicated loans, participants noted *prima facie* potential for three-way cooperation between borrower, bank and debt trader. The

potential to achieve this outcome in the mid-market segment would provide the opportunity for not only greater debt-trading liquidity to allow senior lenders to "trade out" of their distressed debt position, but also the substitution of trading banks with distressed-debt specialists actively focused on achieving a return on their investment through restructure.

Whilst such secondary debt trading represented an innovative and ground-breaking approach to facilitating the rescue of distressed companies in Australia, the findings highlighted reservations about the extent to which the scheme of arrangement provisions really represented a broader corporate rescue rehabilitation mechanism. The strong preference for retention of control by distressed-debt traders - usually hedge funds - has seen the restructuring process for these companies primarily occur through such schemes or informally, rather than through the Part 5.3A process. In particular, participants reported that debt traders looking to force an issue, such as a loan-to-own strategy, had driven the re-emergence of the scheme of arrangement legislation because of its surgical ability to achieve specific agenda outcomes like debt-to-equity swaps and specific creditor-class cram-downs. Inevitably, and consistent with Harmer (1988), participants recognised that the successful execution of a scheme of arrangement was a tough process that occurred over a long time, and that this was inconsistent with the time criticality for most insolvent companies. Furthermore, the significant court involvement and associated prohibitive cost requirements and outcome uncertainty were reported to rule out this option for most distressed companies.

STRENGTHS, LIMITATIONS AND FUTURE DIRECTIONS

A strength of this research was the qualitative approach that captured the perceptions and experiences of insolvency practitioners to gain a first-hand practical insight into the operating effectiveness of the Part 5.3A legislation in Australia. This understanding of participants' views is significant in that insolvency practitioners not only have the responsibility and expertise to administer companies under the Part 5.3A framework, but are also independent of key stakeholders, and can thus provide objective and relevant feedback. However, they also have the potential for bias and self-interest surrounding these responsibilities, which include the independent assessment and judgement powers pivotal to the current legislation's operation. As reported in Chapter 4, practitioners who agreed to participate expressed a strong interest in the research topic, which raises the potential issue of skewed data as a result of a "reformist" bias in the study population. The findings were also limited by the extent of participants' working knowledge of frameworks in other jurisdictions. Qualitative research is inherently limited in its generalizability, and this is a result of the 'human' data collector as well as the inability to randomly sample in the present research. Lastly, my background as a banker may have biased participants in their responses, as bankers usually oversee the referral of distressed companies to insolvency firms.

Further research may do well to test some of the relevant assertions in this thesis using deductive means, which was beyond the scope of the present study. Future research should develop a greater statistical understanding of the insolvency framework, including under Part 5.3A and the surrounding restructuring outcomes post-

appointment. This statistical understanding would capture the quantum of companies entering into and completing a DOCA or being placed into liquidation, and ideally would extend to understanding the percentage of the pre-appointment business that emerges from the insolvency process as a going concern, whether through company restructure or business sale. Such a quantitative understanding of the insolvency statistics, which to date have been the subject of limited empirical research and anecdotal evidence, would provide an important perspective on corporate rescue as a matter of course, and the need for the reform of the insolvency process.

RECOMMENDATIONS

The findings of this research have provided insight into useful ways in which corporate restructuring in Australia can develop. This section will outline the key recommendations to advance the Part 5.3A voluntary-administration legislation and the broader insolvency framework in Australia. These changes are aimed at improving the effectiveness of rehabilitation processes and the likelihood of distressed companies rehabilitating successfully, focusing on eight key areas:

1) The realignment of the insolvency framework and Part 5.3A restructuring focus in Australia towards prioritised rehabilitation and going-concern preservation, by relegating the timing of regulatory-enforcement and accountability outcomes.
2) Legislative change to extend moratorium protection to the enforcement of *ipso facto* clauses under the Part 5.3A framework;

3) Reconsideration of the insolvent-trading framework and the abandoned Safe Harbour initiatives to facilitate improved bona fide informal restructuring, including the potential role of a chief restructuring officer;
4) Improved guidelines surrounding practitioner independence to facilitate greater planning and pre-defined strategy development for rehabilitation prior to an administrator's appointment, particularly for larger, complex appointments;
5) Refinements to the Part 5.3A framework to better align with the restructure of medium to large companies, including in relation to reporting timelines and procedural obligations, supported by scope-of-work scale-back guidelines for small companies;
6) Improved guidelines surrounding court direction to achieve complicated or creative restructuring outcomes, including prospective immunity from insolvent-trading liability in an informal work-out, and the ability to pursue broader social stakeholder outcomes;
7) Reforms to the GEERS legislation to provide greater scope for safety-net entitlement support to restructuring under the Part 5.3A framework; and
8) Improved director-education requirements, including (as a minimum) the completion of a directors course focused on ensuring awareness of directors responsibilities, fiduciary duties and record-keeping. Formal accreditation requirements could ensure this.

The present research findings suggest the need for incremental improvement, not wholesale shift in legislation and framework. Ongoing and evolving transition to a corporate-rescue culture, including the implementation of the recommendations above,

are critical to ensuring prosperity and efficiency in the Australian economy and the balancing of broader stakeholder interests.

CONCLUSION

The present research occurred at a time of growing financial uncertainty in the world economy and a significant need to ensure cyclical viability of companies, and, indeed, the stability of the Australian economy as a whole. Alongside this growing uncertainty, the form in which corporations are financed has become transcendentally more complex due to the shift towards greater informal restructuring, the role of turnaround advisers and the introduction of the secondary distressed debt market. With such pressure to ensure the sustainability of Australian companies, the way in which distressed companies are handled has become a key issue in ensuring Australia's financial health. The present research has sought to understand the constraints upon the successful rescue of distressed companies, and has subsequently provided a number of recommendations that would see increased stability across the range of small to large corporations. The recommendations highlight the need for and are conducive to a corporate-rescue culture, ensuring that viable companies and businesses will be more likely to successfully restructure as a matter of course and thus restored to financial health.

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Appendix A: Insolvency: A Glossary of Terms

(Adapted from the document titled Insolvency: A Glossary of Terms available from www.asic.gov.au)

Asset Any property of value owned by a person. Can include tangible and intangible assets.

Charge A form of security for a debt taken by a creditor over company assets. A mortgage is a type of charge.

Compromise Agree to accept a lesser sum in full payment of a debt.

Controller A person appointed by a secured creditor to deal with assets subject to a charge. Includes a receiver, and receiver and manager.

Court liquidation A liquidation that starts as a result of a court order, made after an application to the court, usually by a creditor of the company.

Creditor A person who is owed money.

Creditors' voluntary liquidation A liquidation for insolvent companies, initiated by the company. Creditors may replace the liquidator appointed by the company in this type of liquidation.

Debtor A person who owes a debt.

Deed administrator The external administrator appointed to oversee a deed of company arrangement.

Deed of company arrangement A binding arrangement between a company and its creditors governing how the company's affairs will be dealt with, which may be agreed to as a result of the company entering voluntary-administration. Aims to maximise the chances of the company, or as much as possible of its business, continuing, or to provide a better return for creditors than an immediate winding up of the company, or both.

Director A natural person appointed as a director of a company who is then responsible for directing and managing the affairs of a company. Also includes a shadow director.

Dividend A share of the profit of a solvent company paid to shareholders. Also used to describe a sum paid to creditors out of the assets of an insolvent company.

Eligible employee creditor A creditor (including the Australian Taxation Office in respect of the superannuation guarantee charge) who, in a winding up of a company, would normally be paid their employment-related entitlements in priority to other unsecured debts. These creditors are given a special right to vote on a deed of company arrangement proposal that seeks to modify their priority.

External administrator A general term for an external person formally appointed to a company or its property. Includes provisional liquidator, liquidator, voluntary-administrator, deed administrator, controller, receiver and receiver and manager. Other than a liquidator for a members' voluntary liquidation and a controller who is not a receiver or receiver and manager, an external administrator is required to be registered by ASIC. An external administrator is sometimes also referred to as an insolvency practitioner.

Fixed charge A charge taken by a lender over particular assets of a company. The company may not dispose of these assets without the consent of the lender.

Floating charge A charge taken by a lender over general assets of a company. The company is usually able to use and dispose of these assets (e.g. stock, debtors) in the ordinary course of business without the secured creditor's consent. A floating charge converts to a fixed charge over those assets if certain events listed in the charge document occur. These usually include the appointment of a liquidator or other external administrator.

GEERS The General Employee Entitlements and Redundancy Scheme—a basic payment scheme to assist employees who have lost their jobs as a result of their employer's liquidation or bankruptcy, and are owed certain employee entitlements.

Indemnity An agreement between the external administrator and a third party to cover the fees and other debts incurred by the external administrator.

Insolvent Unable to pay all debts when they fall due for payment.

Liquidation The orderly winding up of a company's affairs. It involves realising the company's assets, cessation or sale of its operations, distributing the proceeds of realisation among its creditors and distributing any surplus among its shareholders. The three types of liquidation are: court, creditors' voluntary and members' voluntary.

Liquidator A natural person appointed to administer the liquidation of a company.

Officer (of a company) A director, secretary or external administrator (in most cases) of the company.

Priority creditor An unsecured creditor entitled to be paid ahead of other creditors (e.g. employees).

Receiver An external administrator appointed by a secured creditor to realise enough of the assets subject to the charge to repay the secured debt. Less commonly, a receiver may also be appointed by a court to protect the company's assets or to carry out specific tasks.

Receiver and manager A receiver who has, under the terms of their appointment, the power to manage the company's affairs.

Receivership An insolvency procedure where a receiver, or receiver and manager, is appointed over some or all of the company's assets.

Secured creditor A creditor who has a security (e.g. charge or mortgage) over some or all of a company's property.

Shadow director A natural person not on the public register as a director of a company but who directs and manages the company's affairs and is taken by the *Corporations Act 2001* to be a director.

Uncommercial transaction A transaction that was unreasonable for a company to have entered into. It may be able to be set aside by the company's liquidator provided it occurred within two years prior to the winding up, and when the company was insolvent or if the company became insolvent by entering into the transaction.

Unfair preference A payment made or other benefit given to a creditor by an insolvent company which causes that creditor to be in a more favorable position than other unsecured creditors in a liquidation. The company's liquidator can seek to recover an unfair preference provided it occurred within six months prior to the liquidation, and when the company was insolvent or if the company became insolvent by making the payment or giving the benefit.

Unsecured creditor A creditor who does not hold a security over a company's property.

Voluntary-administration An insolvency procedure where the directors of a financially troubled company or a secured creditor with a charge over most of the company's assets appoint an external administrator called a "voluntary-administrator". The role of the voluntary-administrator is to investigate the company's affairs, to report to creditors and to recommend to creditors whether the company should enter into a deed of company arrangement, go into liquidation or be returned to the directors.

Voluntary-administrator An external administrator appointed to carry out the voluntary-administration of a company.

Winding-up order A court order for the winding up of a company. The first step in a court liquidation. Usually made after an application by a creditor.

Appendix B: Higher Research Ethics Approval

University of Wollongong

INITIAL APPLICATION APPROVAL
In reply please quote: HE12/002
Further Enquiries Phone: 4221 3386
MR:SH

19 January 2012

Professor John Glynn
Sydney Business School
Level 8, 1 Macquarie Place
SYDNEY NSW 2000

Dear Professor Glynn,

I am pleased to advise that the Human Research Ethics application referred to below has been **approved.**

1. The answer to Question 31 on the Ethics application form relating to Confidentiality & Privacy should perhaps be included under the Possible Risks, Inconveniences and Discomforts heading on the Participant Information Sheet.
2. Please include the Ethics Office email address after the phone number on the Consent Form (rso-ethics@uow.edu.au).
3. Please note that Renewal will be required annually.

Ethics Number:	HE12/002
Project Title:	Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspectives of the Australian Part 5.3A Legislation
Researchers:	Professor John Glynn, Ms Judith Marychurch, Dr Bill Wilkinson, Mr Michael Blazic
Approval Date:	19 January 2012
Expiry Date:	18 January 2013

The University of Wollongong/Illawarra Shoalhaven Local Health District Social Sciences HREC is constituted and functions in accordance with the NHMRC *National Statement on Ethical Conduct in Human Research.* The HREC has reviewed the research proposal for compliance with the *National Statement* and approval of this project is conditional upon your continuing compliance with this document.

A condition of approval by the HREC is the submission of a progress report annually and a final report on completion of your project. The progress report template is available at http://www.uow.edu.au/research/rso/ethics/UOW009385.html. This report must be completed, signed by the appropriate Head of School, and returned to the Research Services Office prior to the expiry date.

As evidence of continuing compliance, the Human Research Ethics Committee also requires that researchers immediately report:

Research Services Office University of Wollongong NSW 2522 Australia
Telephone: +61 2 4221 3386 Facsimile: +61 2 4221 4338
research-services@uow.edu.au www.uow.edu.au/research

- proposed changes to the protocol including changes to investigators involved
- serious or unexpected adverse effects on participants
- unforseen events that might affect continued ethical acceptability of the project.

Please note that approvals are granted for a twelve month period. Further extension will be considered on receipt of a progress report prior to expiry date.

If you have any queries regarding the HREC review process, please contact the Ethics Unit on phone 4221 3386 or email rso-ethics@uow.edu.au.

Yours sincerelv

A/Professor Garry Hoban
Chair, Social Sciences
Human Research Ethics Committee

Appendix C: Participant Information Sheet

SYDNEY BUSINESS SCHOOL
University of Wollongong

PARTICIPATION INFORMATION SHEET

TITLE: *Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspectives of the Australian Part 5.3A Legislation*

PURPOSE OF THE RESEARCH
This is an invitation to participate in a study conducted by researchers at the University of Wollongong. The purpose of the research is to investigate the challenges and barriers towards the restructuring of Australian companies in practice.

INVESTIGATORS

Mr Michael Blazic	Professor John Glynn
Sydney Business School	Sydney Business School
02-8254 7621	02-4221 5779
mjb368@uow.edu.au	john_glynn@uow.edu.au

METHOD AND DEMANDS ON PARTICIPANTS
If you choose to be included, you will be asked to participate in an interview with Michael Blazic. The interview will last for approximately 1 hour, and with your permission will be audiotaped to ascertain the factors pertinent to your perspective on corporate rehabilitation.

POSSIBLE RISKS, INCONVENIENCES AND DISCOMFORTS
Apart from the approximate hour of your time for the interview, we can foresee no risks for you. Your involvement in the study is voluntary and you may withdraw your participation from the study at any time and withdraw any data that you have provided to that point. Refusal to participate in the study will not affect your relationship with the University of Wollongong or with Michael Blazic or any organisation he is employed under.

FUNDING AND BENEFITS OF THE RESEARCH
This research will provide a basis for future understandings of corporate rehabilitation in Australia. Findings from the study will be published in a thesis and possibly published in insolvency and law journals/conferences. Confidentiality is assured, you will not be identified in any part of the research.

ETHICS REVIEW AND COMPLAINTS
This study has been reviewed by the Human Research Ethics Committee (Social Science, Humanities and Behavioural Science) of the University of Wollongong. If you have any concerns or complaints regarding the way this research has been conducted, you can contact the UoW Ethics Officer on (02) 4221 4457 or rso-ethics@uow.edu.au.

Thank you for your interest in this study.

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Appendix D: Participant Consent Form

SYDNEY BUSINESS SCHOOL
University of Wollongong

CONSENT FORM

Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspectives of the Australian Part 5.3A Legislation

Michael Blazic

I have been given information about Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspectives of the Australian Part 5.3A Legislation and discussed the research project with Michael Blazic who is conducting this research as part of a Doctorate of Business Administration supervised by Professor John Glynn in the Sydney Business School at the University of Wollongong.

I have been advised of the potential risks and burdens associated with this research, which include approximately one hour of my time for an interview, and have had an opportunity to ask Michael Blazic any questions I may have about the research and my participation.

I understand that my participation in this research is voluntary, I am free to refuse to participate and I am free to withdraw from the research at any time. My refusal to participate or withdrawal of consent will not affect my current or future relationship with Michael Blazic or any organisation that he is employed under.

If I have any enquiries about the research, I can contact Michael Blazic on (02) 8254 7621 or Professor John Glynn on (02) 4221 5779. Further, if I have any concerns or complaints regarding the way the research is or has been conducted, I can contact the Ethics Officer, Human Research Ethics Committee, Office of Research, University of Wollongong on 4221 4457 or rso-ethics@uow.edu.au.

By signing below I am indicating my consent to

- Participate in an interview with Michael Blazic on the Part 5.3A Voluntary Administration legislation.
- Have the interview audio recorded for the purposes of data analysis.

I understand that the data collected from my participation will be used for the purpose of a thesis and potential journal/conference publications, and I consent for it to be used in that manner. Only the researcher will have access to audio recordings of interviews, which will be kept on a pass-word accessed computer with a secure server. Pseudonyms will be used to identify participants.

Signed   Date

..../....../......

Name (please print)

....

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Appendix E: Invitation To Participate

SYDNEY BUSINESS SCHOOL
University of Wollongong

<<Name>>
<<Company>>
<<Address>>
<<Address>>

Dear <<Name>>,

My name is Michael Blazic, and I am a Doctor of Business Administration candidate at the Sydney Business School, University of Wollongong under the supervision of Professor John Glynn. My research is titled "Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspectives of the Australian Part 5.3A Legislation". The main focus of this research relates to the Voluntary Administration Part 5.3A legislation as the mechanism for corporate restructuring of companies in Australia and its effectiveness as a restructuring tool in practice.

You have been contacted because you are a Registered Liquidator / Official Liquidator / Legal Practitioner specialising in the insolvency field, and as such you will be familiar with the use of the legislation to restructure companies in practice. The purpose of my research is to explore how insolvency practitioners perceive the Part 5.3A legislation and in particular, your views on its operation and effectiveness, including any practical barriers to the efficient restructuring of viable companies.

Your participation in this project would be highly valued because of your expertise gained in the practice of insolvency and experience in operating within this legislative framework. It will be helpful to gain an insight into your perspectives on how the advancement of a corporate 'rescue-based' culture could be facilitated in Australia and gain feedback on the relevant issues insolvency practitioners are experiencing in administering the legislation, which inhibit best practice.

Attached to this letter is a participant information sheet and consent form, relating to participation in an interview for the project (approximately 1 hour). Please return the consent form in the enclosed envelope should you wish to participate in this research. Should you require any further information about the project, please do not hesitate to contact me on (02) 8254 7621 or via email on mjb368@uow.edu.au.

Yours sincerely,

Michael Blazic
DBA Candidate

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CRICOS PROVIDER NO: 00102E

Appendix F: Interview Guide

Can I ask a few details about yourself?

a) How long have you been working in the insolvency field?
b) What size practice do you work for (small, mid, large)?
c) What is the revenue range of companies you work?
d) What is the % breakdown mix of your appointment or work type; e.g., voluntary administration, liquidation, receivership, advisory.

Based on your experiences as an insolvency practitioner:

1) Overall, what do you think should be the aim of the Part 5.3A legislation and what forms can a successful outcome take?

2) In practice, how effective or otherwise do you think the Part 5.3A legislation operates to facilitate the rehabilitation of distressed or insolvent companies?

3) What have you found to be the practical barriers to the restructuring of distressed Australian companies under the Part 5.3A legislation, and what changes would be needed to address this?

4) Current literature includes theories surrounding i) *ipso facto* clauses; ii) secured creditor enforcement; iii) the insolvent trading regime; iv) administrator trading risk exposure; and v) employee entitlements as potential legislative barriers to restructuring. In your practical experience, what is your opinion on the applicability of these theories?

5) Thinking about the companies you have worked with in VA, what percentage of companies have the potential to be restructured as a going concern?

6) Do you think there is a difference between the ability for small and large companies to restructure (assuming the ASIC definition) under the legislation?

7) What do you think about the idea of a corporate “rescue-based culture”? Does this culture exist in Australia, and how could improvement be facilitated?

8) What do you think of a transition towards a more “debtor-friendly” framework, such as the US Chapter 11 legislation, for a reconsideration of the Part 5.3A legislation?

9) In your opinion, has the role of informal restructuring and advisory increased in importance and scope compared to formal appointment mechanisms to rehabilitate distressed companies?

10) Is there anything I haven’t asked you that you think it would be helpful for us to talk about?