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Committee Secretariat
Senate Standing Committee on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Sir/ Madam

Inquiry into the causes and consequences of the collapse of listed retailers in Australia

CPA Australia represents the diverse interests of more than 155,000 members in 118 countries. Our vision is to make CPA Australia the global accountancy designation for strategic business leaders. We make this submission on behalf of our members and in the broader public interest.

CPA Australia welcomes this inquiry as we have publicly supported a community discussion on the collapse of Dick Smith Holdings Ltd[1]. Subject to what may emerge from such a discussion, CPA Australia is not convinced of the need for any insolvency law reform arising out of these events.

However, there are wider issues which go to community expectations of ethical conduct and the public interest behaviour of market participants. We also note that the Corporations Act allows for investigation of transactions which occur in the lead up to a corporate failure.
We provide the below comments in response to the following terms of reference:

The conduct of private equity firms prior to, during and after corporate takeovers

As a general statement CPA Australia is of the view that anyone, including private equity firms, has the right to identify underperforming and/ or undervalued assets or businesses, transform them, and maximise returns for themselves or their investors.

As we know, Dick Smith electronics stores have been through a private equity "transformation" process. As has been widely reported in the news media, while the sale price was $115 million, the private equity firm only paid somewhere between $10-20 million with their own money, depending on which reports you believe.

The subsequent Initial Public Offering (IPO) was successfully completed at the end of 2013. The investment of $20 million turned into a business with a market capitalisation of $520 million.

As indicated in our public commentary, “the process of flipping a business in 12 months and making $500 million while putting 3300 jobs on the line doesn’t feel right… there’s an ethical gulf which deserves community discussion.”

We acknowledge that there are many players involved, in addition to the private equity firm. There’s the original owner (Woolworths), the board and executive management of the listed entity, financial institutions and investors, both institutional and those who advise mums and dads.

[1] http://www.smh.com.au/comment/private-equitys-role-in-the-dick-smith-saga-hardly-serves-the-public-interest-20160119-gm9mpb.html

We contend that these sorts of events can have the effect of undermining public trust in the mechanics of the business community. As such, thorough scrutiny of antecedent transactions and disclosures made as part of the fundraising is warranted to provide reassurance that all requirements pursuant to an IPO have been met.

The Senate is to be congratulated for drawing public attention to these issues, with a report due by 12 May 2016. We also note that the administrator is due to report findings and recommendations on possible offenses to ASIC later in the year. Taken together, these reports will contribute to greater transparency around the circumstances of the collapse.

The role of the Australian Securities and Investments Commission and the Australian Competition and Consumer Commission in overseeing corporate takeovers

The takeover provisions within Chapter 6 of the Corporations Act 2001 have evolved over time to achieve an appropriate balance between informing investors on both sides of the transaction and in achieving market efficiency.

We see nothing in the events giving rise to this inquiry which would call into question the efficacy of these provisions. We nevertheless urge appropriate examination of the specifics of the Dick Smith collapse by ASIC under its extensive powers provided for in the ASIC Act 2001.

The effect of the appointment of external administrators on secured and unsecured creditors, including employees and consumers of retail businesses

The Committee will be aware of extensive consideration given by the Productivity Commission (PC) in its 2014/ 15 inquiry into Business set-up, Transfer and Closure to which Government response is still forthcoming. A number of insolvency law reforms stemming from the PC's wide ranging review have been picked up in the December 2015 National Innovation and Science Agenda, and have adopted a stronger theme of business rescue. Nothing in these deliberations point to difficulties in the current proprietary-based favourable treatment afforded secured creditors, nor that the rules protecting employee entitlements are weak.

If, as perhaps there is hinted in this term of reference the need for specific rules, relief and remedy related to a particular industry or type of commercial relationship, this should be avoided with vigour. The broad structure and specific rules of the Corporations Act's external administration provisions (Chapter 5) apply across all sectors of the economy. Neither isolated events, nor broader stresses of industry's transformation, should be the basis of insolvency law reform which must endure with predictability across economic cycles. Even were it to be proven that Dick Smith stores were accepting monies in exchange for gift cards in the period immediately prior to appointment of administrators, such funds would be commingled. Though regrettable, there is nothing that should distinguish these payers from other unwitting creditors caught up in the unfortunate demise. The transfer of funds does not create a proprietary interest, nor is the relationship of a fiduciary character. Quite correctly, insolvency distribution rules avoid such indeterminacy that would reduce the payee's estate available for distribution to all creditors.

Australia's insolvency laws are robust, serving well a combination of needs including those of creditors and, more generally, market efficiency. Company liquidators work under a positive obligation to investigate and report to ASIC on suspected breaches of both specific and general duties of a wide range of parties involved in the affairs of a failed company. Moreover, the Corporations Act affords considerable power to liquidators to handle a broad spectrum of matters that may arise in the specific circumstance of the lead up to a corporate failure. These include the capacity to wind-back a wide range of antecedent transactions. The underlying principle being to augment the funds available to the general body of creditors, rather than arbitrarily seeking out a class of creditor who might at some point in time, in subjective terms, considered more deserving.

Additionally, liquidators are able to seek the intervention of the Courts if there are concerns that there has been concealment or removal of property or books.

The effect of external administration on gift card holders and those who have made deposits on goods not delivered

There is nothing in these and similar events that would point in any way to a need to upset the current circumstance where these two types of claimant are treated equally (pari passu). The law has not, and should not, through statutory intervention, create a security or priority where one was not intended by the parties, this particularly so where there is no identifiable property to which such a right would attach.

Further, such a statutory intervention could lead to others being adversely impacted, such as unsecured creditors – creditors who could have significantly more to lose than gift card holders.

The desirability of the following proposals in the event that gift card holders are unable to redeem their gift cards following the appointment of external administrators:

i. ***placing an obligation on external administrators to honour gift cards***

Such a requirement would strike at the very heart of the statutory obligation of external administrators and company liquidators to treat and represent the interest of unsecured creditors in a fair and equitable manner.

ii. ***a requirement that funds used to purchase gift cards be kept in separate trust account by businesses***

Of the three proposals under this term of reference, this is the least offensive. Nevertheless, there are likely to be significant difficulties if pursued. For example, what will be the nature of the trust relationship – a purely retail trade dealing is not one typically occasioned by reliance or vulnerability to which a trust relationship would apply. Moreover, it is difficult to contemplate how the trust relationship could be sustained upon passing on of a gift card – who has beneficial entitlement, the purchaser or any subsequent holder who may leave the card in their 'sock draw' for an indeterminate amount of time? It needs, of course, also to be mentioned the practicalities of adverse impact on cash flow and record keeping.

iii. ***directors to be personally liable for the value of gift cards purchased***

The Corporations Act in Part 5.7B Division 3 (Director's duty to prevent insolvent trading) and Division 4 (Director liable to compensate company) has highly developed and well understood mechanisms for rendering directors personally liable for company debts when trading insolvent. The positive incentives stemming from these provisions are powerful. Selective treatment of the type contemplated here is unwarranted.

If you require further information on our views expressed in this submission, please contact Dr John Purcell, CPA Australia

Yours sincerely

Alex Malley FCPA
Chief Executive