IN THE MATTER

OF AN INQUIRY INTO THE CAUSES AND CONSEQUENCES OF THE COLLAPSE OF LISTED RETAILERS IN AUSTRALIA (INQUIRY)

SUBMISSION OF PROFESSOR MICHAEL QUINLAN, ASSOCIATE PROFESSOR A KEITH THOMPSON AND PHILIP STERN

To: **The Secretary**
Senate Economic Reference Committee
Inquiry into the causes and consequences of the collapse of listed retailers in Australia

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The Petitioners make no submissions into reference items (a) and (b). With respect to the remaining reference items the Petitioners submit as follows:

(c) the effect of the appointment of external administrators on secured creditors and unsecured creditors , including employees and consumers of retail businesses.

There is no doubt that the appointment of external administrators has a deleterious effect on virtually all stakeholders of the affected company. Those affects could be ameliorated by safe harbour provisions for directors which allow for adequate time for the directors to turn a business around without the risk of personal liability for insolvent trading being incurred by the directors if a turnaround is unsuccessful. The outlawing of ipso facto clauses during the external administration would also assist in this regard. This would ensure supply of goods and services in term contracts, thus better ensuring trading continuity. (The suppliers would still be practically ensured of payment by the personal liability obligations imposed on the external appointees by ss 419 *Corporations Act, 2001* (Cth)[1] as to controllers and s443A as to voluntary administrators .The position of

[1] Note all section references in this Submission are to sections in this Act

liquidators is different as liquidation is not intended to operate as a vehicle for restructuring or turnaround and is usually the death knell of the company) .

Reasons as to why the appointment of external administrators frequently signals the end of a company and hence is deleterious to stakeholders include:

1 The inability to provide goods or services, and /or the consumer perception that ongoing supply of goods and services and warranty support will not be available. This means that people are unwilling to contract with externally administrated companies .This is compounded by the statutory obligation to communicate the impaired status in all documentation (ss 428, 450E).

2 There is no real rescue culture in our society. There is a public perception that the appointment of voluntary administrators represents the end of a company, the loss of jobs, unpaid debts and of business. This may, of course, be **one** potential result of a voluntary administration but so too may be a successful rehabilitation or turnaround of the company or the business. Until voluntary administration is perceived as a legitimate means of seeking to save (rather than destroy) a business and the legislative framework facilitates this, rehabilitation and turnaround will remain elusive.

3.The appointment of a voluntary administrator (whose main aim is to resuscitate the company or maximize returns (s 435A) frequently triggers the appointment of receivers and managers by a secured creditor (whose main aim is to ensure full payment to the secured creditor i.e. an aim which differs significantly from the aim of an administration and which is mostly at odds with the voluntary administrator appointment and aims). Indeed the secured creditor can not only enforce its security on a breach of its terms, but also can proceed simultaneously to seek to have a liquidator appointed by reason of its own appointment of receivers over circulating security assets (s 459C (2)(c) as applicable to s 459A).Again this is often the death knell of the company.

3 On current law, directors of companies have little alternative when a company is insolvent or likely to be insolvent, but to appoint external administrators or to put the company into liquidation. Indeed the current law has been developed to provide directors with strong incentives to make such appointments. If they do not do so they risk personal liability by operation of ss 588G (on a liquidation) and 181 (as incurring debts which cannot be met when due is a general breach of director duties to the company concerned). The costs involved in the voluntary administration process compared to a creditors voluntary liquidation, mean that directors frequently choose the simpler option of liquidation Insolvency practitioners, not unfairly, often ask for a sum to be paid upfront to cover administration costs. Smaller amounts are required for a voluntary liquidation which does not require two creditor meetings and a detailed report. Whilst turnaround is an objective of voluntary administration, it is not an objective of voluntary liquidation. However, a liquidator has power to appoint a voluntary administrator and so to start that potential rehabilitation process (s436B), but that option is rarely used in practice. The requirement for a liquidator seeking to appoint him or herself as voluntary administrator (and thus save costs because of familiarity with the company's affairs) to first get leave of the Court is a further disincentive to rehabilitation.

4 There are extraneous factors which often cause the demise of a company that might otherwise have been saved. These include:

(a) the tax laws provide that a tax assessment is a debt due and payable 30 days after the assessment, regardless of whether the tax debt is genuinely disputed by the taxpayer and is subject to appeal. In other words, directors can have immediate potential

personal exposure for disputed tax debts, which can render a company immediately insolvent notwithstanding that there in a genuine dispute about that indebtedness and ultimately the tax debt is found to be not payable by appellate courts. Directors may trigger administrator appointments to avoid the risk of personal liability, notwithstanding that the company in truth may have been solvent when the tax position is finally determined.
(b) Practitioner experience is that the Australian Taxation Office in practice does not vote in favour of compromise deeds of company arrangement even if beneficial to creditors generally. The vote of the ATO can be determinative of the creditor resolution succeeding or not.
(c) The attitude of trade credit insurers in the retail industry (in which insurance is prevalent) often is that insurance payments will not be made unless the insured takes all steps to see payment is made in full or there is no prospect of any payment. This means that there is a positive encouragement for the insured in this circumstance to oppose any creditor compromise of indebtedness so that it is clear that there is no prospect of payment and the insurer will pay out. A more flexible and commercial approach by insurers in which they pay claims and then seek to recover some of their claim by the exercise of subrogation rights is to be encouraged perhaps by a legislative response.

5 .As the objective of receivership is the recovery of the secured debt there may be little or no incentive for the secured creditor to carefully scrutinize the costs of the receivership in circumstances where the secured assets will be sufficient to repay the secured creditor's debt in full together with the receivership costs. As a result the cost and duration of receiverships may exceed those what is necessary were there a party with an interest in recovering from the excess of the assets who had a ready ability to review receiver costs and disbursements. Where receivership costs are excessive, unsecured creditors receive less than they should, and guarantors have to meet any corporate asset realization shortfall (including from guarantee mortgages over the directors' homes).Of particular concern is that receiver fees are not transparent. Unlike liquidations or voluntary administrations, where fees are explicitly subject to either creditor or court approval processes, including by provision of itemized accounts (after court decisions to that effect), receivers' fees are a matter of contract between the receiver and the appointor. They are not subject to direct or immediate creditor or court scrutiny before payment. Whilst receivers are obliged to lodge 6 monthly accounts at ASIC pursuant to s 432 they are often lodged late, the accounts are in summary form and if a corporate group is involved, the fees are often (wrongly) grouped into the holding or operating company. Whilst excessive fees can be challenged under s434A, or on inquiry under s423 the challenging party must bring an action against the secured creditor (usually a trading bank) which has contractually indemnified the receivers from all claims. That is a rare and expensive process. In short, there is a serious lack of transparency in the receivership cost process. Receivers frequently stay in their role long after realization of assets on the basis that there could potentially be claims on them until expiry of limitation periods (when in fact none surface within reasonable time), or because of tardiness in finalizing affairs frequently because of more pressing administrations. In practice, the company cannot re-establish itself while the receivers remain in office and the cost of making an application to challenge a redundant receiver under s 434B is prohibitive for most stakeholders.

6 The result of the recent (by majority) appellate decision in *Australian Gypsum Industries Pty Ltd v Dalesun Holdings Pty Ltd* [2015] WASCA 95. In that case, a

successful Deed of Company Arrangement released a secured creditor's contingent liability and the secured creditor could not enforce its security. Unless that decision is overturned on appeal or reversed by statutory amendment, secured creditors are more likely to enforce their securities when a company goes into voluntary administration than in the past.

(d) the effect of external administration on gift card holders and those who have made deposits on goods not delivered

Obviously it is unfortunate that gift card holders do not receive full value for their vouchers. However all unsecured creditors suffer in a corporate collapse. There is no separate proper basis to distinguish the position of gift card holders from other damaged stakeholders including employees, suppliers (often small businesses and employers in their own right) , government instrumentalities landlords and financiers, many of whom presumably defray their losses by increasing charges to others .If gift card holders are preferred in insolvency administrations over other unsecured creditors then other unsecured creditors will suffer further losses with consequent multiplier effect in some cases.

(e) 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 ,

This is undesirable as it prefers this category of creditor to all other creditors, who in turn would commensurately have their losses increased

(ii) a requirement that funds used to purchase gift cards be kept in a separate trust account by businesses,
This would be commercially undesirable as the cost involved in establishing and maintaining the trust account would be significant and often disproportionate to the sums involved e.g. a $50 gift voucher would likely cost more in administration cost than $50.The costs involved would likely lead to many retailers, particularly small businesses, withdrawing this line of gift from their operations and this could have deleterious effects on Australian businesses.
What could occur to alleviate the position is that a separate fee be imposed on all vouchers for the purpose of payment into a fidelity fund, which upon a corporate collapse, could be used to partly alleviate gift card holder losses. The Fund could accrue interest, tax free, and accrue over time to the further benefit of any future claimants.The Fund would be administered as one corpus only without the cost of administering separate trust accounts
Another alternative is for there to be mandatory bank /insurance/ government backed guarantees of gift cards .However the cost of the financier backing could be prohibitive and could result in businesses not offering gift cards. Again this could have deleterious effects on Australian businesses, but a decision by retailers not to offer gift cards for practical reasons, may be preferable to a new law which outlawed retailers offering such cards to avoid insolvency risk.

(iii) directors to be personally liable for the value of gift cards purchased;
This would likely result in gift cards being withdrawn as a consumer purchase option. Again this could have deleterious effects on Australian businesses.

(f) any related matters

There should be a mandatory warning on all gift cards that in the event of the appointment of external insolvency administrators to the retailer that the cards may not be honoured in whole or part, and that the holder may then have rights only as an unsecured creditor of the retailer. If any of the above suggestions are adopted as law reforms the warning should inform consumers of their rights in the event an external administrator is appointed.

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