TMA SUBMISSION

SENATE STANDING ECONOMICS COMMITTEE INQUIRY

TREASURY LAWS AMENDMENT (2017 ENTERPRISE INCENTIVES NO 2) BILL 2017

6 JULY 2017

RECOMMENDATION

PASS THE BILL IN ITS PRESENT FORM

We understand that the Bill is before a senate sub-committee for further consideration.

We understand that the focus of the review includes the designation of qualifications necessary for advisors to a company in Safe Harbour.

We are writing to you to express our support for the Safe Harbour components of the Bill **in their present form**. In particular, we confirm that we support the present "appropriately qualified entity" test.

The existing wording of the test reflects the fact that the variety of appropriate advisors to a company are as diverse as Australian businesses themselves. Turnaround advisors range from a qualified engineer in far north Queensland with operational turnaround "know how" to an investment bank in Sydney with experience in complex cross-border restructures. In our view, the test should remain broad to allow a company to seek the advice that is right for their business. No exhaustive list of accreditations can possibly cover the range of skill sets and practical experience which can be effectively brought to bear on a turnaround.

However, if the committee considers the advisor test should be reframed to include a list of appropriate accreditations, TMA certified CTP* members should be included in this list. These qualifications are globally recognised as an objective measure of the experience, knowledge and integrity that is necessary to conduct corporate renewal work.

We otherwise endorse the swift passage of the Safe Harbour components of the Bill through parliament.

* see page 6 for details of this accreditation

THE TMA SUPPORTS THE BILL AS DRAFTED

WE SUPPORT THE BILL FOR THE FOLLOWING KEY REASONS

1 Protect vulnerable employees

The TMA supports the stance taken on employee entitlements (including superannuation). This will ensure that **vulnerable creditors are protected** throughout Safe Harbour.

2 Preserve tax revenue

The TMA supports emphasis placed on compliance with **tax reporting obligations** during Safe Harbour.

3 Maintain enterprise value

The TMA believes the Bill strikes an appropriate **balance between protecting creditors and preserving the value of the company**.

4 Save jobs and bolster the economy

The TMA believes that the Bill, as drafted, will **increase the uptake of informal workouts** thereby **protecting existing jobs, fostering entrepreneurship/innovation and strengthening the economy**.
In particular, the TMA **supports the carve-out structure** adopted by the legislation, as a traditional defence would be cold-comfort to directors and likely to result in under-utilisation of Safe Harbour.

For further information on our views on Safe Harbour, please refer to our earlier submissions dated 26 May 2016, 23 December 2016, 24 April 2017.

TMA Australia

WHO SHOULD ADVISE THE COMPANY DURING SAFE HARBOUR?

WE SUPPORT THE EXISTING "APPROPRIATELY QUALIFIED ENTITY" TEST

Every turnaround is different. There is no single accreditation which is necessary or appropriate for advisors to all turnarounds

What we like about the present test:		
✓	**Flexibility**	**Different turnarounds require different skill sets.** The **present test will allow companies to choose the best advisor for their needs,** having regard to the size, industry, complexity and nature of the business and its problems. Some examples are on the next page. For this reason, the **TMA does not support limiting the definition to require the advisor be a member of/accredited by a special interest group – for example registered liquidators.** In particular, while the qualifications of required of a liquidator, administrator or receiver are entirely appropriate for those forms of external administration, a turnaround utilising Safe Harbour protections self-evidently requires different skills. **Above all,** the advisor, should have **experience, training and a track record** of having successfully turned around a company. In some cases, part of the team will include those able to advise on liquidation scenarios, but this will never be the main skillset of and advisor/team involved in a successful turnaround.
✓	**Advisor Accountability**	Under the present test, advisors must be "appropriately qualified" in the sense that they are "fit for purpose". Advisors will be exposed to adverse legal action if their advice and/or "better outcome opinion" is incorrect. In our view, under the present test, **firms and individuals are appropriately incentivised to carefully consider their qualifications, practical experience and resources before accepting an engagement**. Over time, we expect that **industry standards and best practice will evolve** regarding the experience and qualifications necessary to engage in the various Safe Harbour work streams.

TMA Australia

WHY THE BROAD TEST IS IMPORTANT

FINDING THE RIGHT ADVISOR(S) FOR THE COMPANY

Small family owned business

A daughter inherits her father's engineering business. A loan maturity date is looming and there appears to be insufficient cash in the business to make the repayment. She seeks advice from an engineer with operational turnaround experience. The engineer provides advice on operational changes which can be made to improve the business's cash flow. She prepares a business plan and a 12-month cash flow forecast, which she presents to her bank. Using this plan, she successfully negotiates an extension of the loan facility.

Appropriate advisor: engineer with operational turnaround experience

Retail business in the SME space

The CFO advises the board that sales need to increase by 12% in the next 6 months for the company to remain solvent. A management consultant is engaged and recommends improvements to brand, customer experience, staff incentives and the introduction of an online sales platform. The company implements those changes and sales targets are exceeded and cash flow stabilised.

Appropriate advisor: CFO (internal) and management consultant

Airline with turnover > $10m

A major Australian airline is at imminent risk of insolvency. A Certified Turnaround Professional (**CTP**) is engaged, because of the CTP's demonstrated competency in the legal, financial and management aspects of a turnaround , with operational turnaround experience in the sector. The CTP and his team of Certified Turnaround Analysts:

- consult with the company to confirm that Safe Harbour is available, having regard to tax reporting obligations and employee entitlements;
- prepare a turnaround plan, comprising of a set of courses of action that are reasonably likely to lead to a better outcome than immediate liquidation/administration; and
- use existing relationships to negotiate standstill arrangements with major lenders and source options to refinance a facility.

Once the turnaround plan is adopted by the board, an Executive Officer from another airline that has faced similar challenges is appointed to the board. The Executive takes a key role in monitoring the implementation of the turnaround plan against its key milestones and facilitating the operational turnaround of the business.

Appropriate advisors: Certified Turnaround Professional supported by Certified Turnaround Analysts (including lawyers, accountants and investment bankers) and Executive Officer with track record of turning around a business in the same sector.

TMA Australia

WHO ARE WE?

WE ARE THE PREMIER GLOBAL PROFESSIONAL COMMUNITY ON TURNAROUND MANAGEMENT

The TMA

The TMA is the Australian chapter of a 9,300 worldwide member association formed in 1988, focusing on corporate renewal and turnaround management.

TMA is the premier professional community dedicated to turnaround management and corporate renewal.

Our members

TMA's strength comes from its diverse membership - professionals from many disciplines committed to a common goal: to stabilise and revitalise corporate value.

The TMA's membership includes: trading and investment bankers, investment funds, workout bankers, portfolio managers, consultants, liquidators, financial advisors, lawyers, accountants, company directors, managers and turnaround industry veterans.

Technical and practical knowledge of the turnaround and corporate renewal industry is what brings our members together.

Our Safe Harbour Best Practice Guidelines

We have published draft Best Practice Guidelines on the existing Bill. These guidelines have been warmly received by our members. We have enclosed the guidelines with these submissions.

The TMA's view on "appropriately qualified entity" and our CTP members

In the TMA's view, the following expertise should generally be held by the advisor:

- expertise in the operational/management, financial and legal aspects of a restructuring;
- demonstrable turnaround/ restructuring experience; and
- compliance with the code of ethics and professional development requirements of the person's relevant accrediting organisation (if applicable).

All Certified Turnaround Professional (CTP) accredited members of the TMA meet these standards. CTPs are widely recognised as leading turnaround professionals in the Australian market

Further, qualification as a CTP involves the completion of the TMA's Certified Turnaround Analyst (CTA) program, which is a post-graduate level course in strategic management for turnaround, accounting for turnaround and law for turnaround.

In the TMA's view, tertiary qualifications (or their equivalent) in turnaround may be necessary for advisors to hold themselves out as qualified for complex appointments and/or high-value appointments to distressed entities with turnover in excess of $10 million.

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TMA BEST PRACTICE GUIDELINES – NAVIGATING SAFE HARBOUR

Phase	Starting to suspect insolvency/risk of insolvency	Assessing and entering Safe Harbour	Planning course(s) of action	Taking action	Leaving Safe Harbour
Phase Objective	Conduct initial assessment of financial position	Assess availability of Safe Harbour and resolve to enter	Develop and approve a turnaround plan	Implement turnaround plan and monitor performance regularly	Assess the success or failure of the course of action taken
Available Steps	Directors form an initial view on whether the company is solvent or at risk of insolvency	Engage "appropriately qualified entity/entities"*	Enter into standstill arrangements with key creditors (if required)	Hold regular board meetings where the course(s) of action are reviewed and monitored against milestones	Assess whether the company is solvent and has achieved long-term viability or whether a formal insolvency appointment or solvent wind down is required
	Directors seek legal, strategic and financial advice, as appropriate	Assess threshold issues: is the company able to pay employee entitlements and comply with tax reporting obligations?	Form a turnaround committee of key stakeholders (if appropriate)	Company must manage key stakeholders and maintain appropriate financial records	
	The company avoids incurring fresh debt	Urgently take steps to address any officer/employee misconduct	Implement crisis stabilisation and cash management processes (if appropriate)	Directors must continue to comply with all their general law and statutory duties, including financial monitoring	
	Directors document steps taken through board meetings, file notes and records of advice	Determine whether a standstill period can be agreed with financiers/ key creditors	Formulate the turnaround plan. Advisors provide a written "better outcome" opinion on proposed course(s) of action	Company must comply with continuous disclosure obligations (if applicable) and continue to pay employee entitlements and satisfy tax reporting obligations	
	Directors consider insurance position (if appropriate)	Advisors form a view on availability of Safe Harbour. Board passes a resolution to implement Safe Harbour (if appropriate)	Obtain stakeholder approval of plan (if required). Pass board resolution approving the plan (if appropriate)	Change course(s) of action if necessary	
Evidence Outputs	1. Documented assessment of financial status of company by directors and advisors	1. Documented engagement of appropriately qualified entity 2. Confirmation that threshold issues are satisfied 3. Formal recommendation on Safe Harbour 4. Board resolution to implement Safe Harbour (if appropriate)	1. Formal restructuring plan documented, including better outcome opinion 2. Documented stakeholder views (if appropriate) 3. Board resolution to implement the plan 4. Documented timetable and responsibilities for execution	1. Regular board meeting minutes which document continued consideration of plan 2. Progress reports against milestones 3. Updated forecast financial models 4. Appropriate reporting to stakeholders and market	

Timing

The turnaround plan must be implemented within a reasonable period, having regard to the size and nature of the business.

The above visual aid is not necessarily meant to represent a linear structure. The process outlined in this guide should unfold as efficiently as possible. In this regard, it may be appropriate for some actions to occur contemporaneously.

***Who is an "appropriately qualified entity"?**

The legislation does not specify who will constitute an "appropriately qualified entity". In the TMA's view, the following qualifications should be held:

- expertise in the operational, management, financial and legal aspects of a restructuring;
- tertiary qualifications (or their equivalent) in turnaround;
- demonstrable turnaround/ restructuring experience; and
- compliance with the code of ethics and professional development requirements of the person's relevant accrediting organisation.

All Certified Turnaround Professional accredited members of the TMA meet these standards.

The company may be best served by a combination of professionals, including registered liquidators, lawyers, accountants and/or investment bankers.

TMA Australia

Assessment of solvency

The directors must undertake an initial assessment of whether the company is insolvent or at risk of becoming insolvent. Time is of the essence in doing so.

The test for determining whether a company is solvent is whether the company is able to meet its debts as and when they fall due. This is a cash flow test rather than a balance sheet test.

Independent legal and financial advice are recommended at this stage.

The board should defer incurring any fresh debts or expenses and avoid renewing any leases at least until a decision on the appropriateness of Safe Harbour is reached in the following phase.

The steps taken for the solvency assessment should be carefully documented through board minutes, file notes and records of advice. This is important because Safe Harbour may be taken to apply as early as when the directors start deliberating on the course(s) of action.

Consideration should be given to disclosure and notification obligations under any relevant directors' and officers' insurance policies, if applicable.

Further resources

- TMA Elements of a Turnaround
- INSOL Statement of Principles for a Global Approach to Multi Creditor Workouts
- Slatter, Lovett and Barlow, *Leading Corporate Turnaround* (2006) Jossey-Bass

Resolving to enter Safe Harbour

If the board has determined that the company is insolvent (or at risk of insolvency), it must now decide on whether Safe Harbour is available or whether to invoke a formal insolvency process, such as voluntary administration.

If independent legal and financial advice has not yet been sought by the company, such advisors should now be formally engaged. The advice of an "appropriately qualified entity"* is one of the matters on which the Court will look favourably when assessing whether Safe Harbour was properly available to the directors.

The board and advisors must consider whether the company can satisfy the conditions for Safe Harbour. In particular, Safe Harbour is not available if the company is unable to pay employee entitlements and/or comply with its tax reporting obligations.

The disposition of key stakeholders (and in particular financiers) towards standstill arrangements may need to be confirmed, to assess the possibility of action/security enforcement which may adversely affect any Safe Harbour period.

Any concerns that misconduct by officers or employees of the company is occurring that could adversely affect the company's ability to pay all its debts should be urgently addressed concurrently with this assessment process.

The advisor(s) should, based on all available circumstances prevailing at the time, provide a view to the board as to whether Safe Harbour is available to the company.

The board should carefully consider whether Safe Harbour is available to the company and make an appropriate resolution having regard to the advice.

Turnaround Planning

Once the board has resolved that Safe Harbour is available, standstill arrangements with key lenders and other creditors may need to be pursued to give the company time to develop and implement a turnaround plan.

If appropriate, crisis stabilisation, including aggressive cash management, should also begin immediately.

Communication with financiers is usually critical in turnaround situations. Serious consideration should be given to communicating with key financiers and continued engagement with them during the period of Safe Harbour.

The turnaround plan be formulated and it should address operational, strategic and financial issues. The turnaround plan may comprise of one or more courses of action, depending on what is reasonably likely to lead to a better outcome for the company. The plan should contain a clear set of steps required to implement the proposed course(s) of action and a timetable of milestones that are capable of objective assessment.

Advisors should be prepared to provide a "better outcome" opinion on the turnaround plan. This means taking a view on whether the plan is objectively likely to produce a better outcome for the company than the immediate appointment of a liquidator or administrator. The assessment of the better outcome will require careful legal and financial analysis of the individual circumstances and options.

The turnaround plan should be formally adopted by board resolution, if the board is satisfied that the plan is viable and is reasonably likely to produce the requisite "better outcome" for the company.

Implementation and Monitoring

The turnaround should be implemented within a reasonable period and otherwise in accordance with its timetable.

A formal agreement may need to be entered into with financiers to replace any standstill arrangements.

Generally, management should strive to instil sense of urgency and performance-orientation in staff to effect the turnaround plan. Changes to management should be made as necessary, to support the turnaround. Financial controls should remain tight.

The board must carefully monitor the implementation and performance of the turnaround plan against key milestones. Employee entitlements and tax obligations must continue to be met. Relevant financial information should be regularly considered.

All board meetings should be appropriately minuted and board packs containing the relevant advice, progress reports and financial information should be circulated and filed with the minutes. Directors should continue to seek advice from their appointed advisors. In addition, a "restructuring officer" who can act as a special adviser to the chairman of the board may be appointed for efficient project management of the turnaround plan.

Key stakeholders should be kept informed of the progress of the turnaround plan.

The board must continue to comply with general law directors duties. Compliance with any applicable continuous disclosure obligations under the *Corporations Act* and/or ASX Listing Rules must also be maintained.

The turnaround plan should be viewed as a living document. It should be varied, as required, to achieve the requisite "better outcome".

If, at any time, having regard to the prevailing circumstances and the its advice, the board considers that the turnaround plan is no longer viable or the conditions for Safe Harbour can no longer be met, the company must reconsider its options, including proceeding to voluntary administration/liquidation.

Leaving Safe Harbour

Once the plan has been fully implemented (including any necessary variations), the board should re-assess the financial position of the company with the assistance of advisors.

If the workout during the Safe Harbour period has been successful and long-term viability of the company has been achieved, the company should work to institutionalise relevant improvements.

If the company is solvent, but is still underperforming it may be appropriate to consult further with turnaround professionals and consider options such as a solvent wind down or a business/asset sale.

If the company has remained insolvent or become insolvent the board will likely need to make the appropriate resolution to invoke a formal insolvency process.

If the appointment of a voluntary administrator or liquidator follows the Safe Harbour, it is critical that directors comply with their duties to assist the relevant insolvency practitioner(s) and provide books and records as required by the *Corporations Act*.

Failure to do so may result in Safe Harbour protection from insolvent trading liability becoming unavailable to directors.