

Culture or Vulture?

Story: Chris Moriarty

The Chapter 11 debate is focused on legislating so that Australian companies in distress can be allowed to pilot their way out of trouble

Put aside the notion that Ansett would still be flying if US-style Chapter 11 bankruptcy laws applied in Australia. Mark Korda and Mark Mentha, Ansett's administrators, conclusively buried that idea in a recent newspaper interview on the process of voluntary administration. First, Ansett did continue flying for five months under administration. Second, even under Chapter 11, a company must have access to sufficient cash to fund ongoing operations – and Ansett simply did not have this cash.

Even Michael O'Neill, managing director of Pacific Capital Corporation, and the merchant banker and venture capitalist who triggered the debate with his sub-mission to the Joint Parliamentary Inquiry now underway, concedes the point on Ansett when interviewed for this article.

TEARING UP THE CORPSE

However, O'Neill does not concede that Australia's current insolvency laws are fine just as they are. The US Chapter 11 process protects a company from its creditors under certain conditions while restructuring takes place.

Chapter 11, says O'Neill, encourages companies to turn themselves around. Australia's regime, however, is about tearing up the corpse. "The primary goal is not just to clean up - but to turn it around," says O'Neill, citing the damage done to employees, communities, suppliers and shareholders when a company is allowed to fail.

"When you go into voluntary administration, everyone loses; there is not a culture of turnarounds. You have the wrong people driving - people skilled in liquidation. It's like asking an undertaker to administer a beauty treatment," says O'Neill.

Voluntary administrators do not agree. Anthony Elkerton, partner in William Buck Business Recovery, has built a career working through some famously distressed businesses. "We focus only on maximising the returns to creditors," says Elkerton. "The current system gives us the flexibility to do that - we can do almost anything."

Australia's current laws give an administrator a minimum of 28 days to achieve one of three outcomes: hand back to the directors, final liquidation or continuation in some other form under a Deed of Company Arrangement.

This can be almost any imaginable arrangement, just so long as all the creditors agree upon it. Once negotiated, the arrangement is enforced by the courts. Under Chapter 11, a company can be protected from creditors for up to a year while it negotiates a new arrangement. Thus, the key difference is that under Australia's system, an external third party - the administrator - is brought in to decide the way forward and does so in the interest of the creditors. Under Chapter 11, the existing management negotiates the way forward - supposedly in the interests of the shareholders.



At a glance

- A Chapter 11 style regime may give Australian companies in distress an alternative to voluntary administration
- Some argue a turnaround culture already exists in Australia
- A hybrid of existing laws and the US model may be the best approach

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WHO'S GOT THE POWER?

"We take control away from the people who got the business in distress in the first place and make the changes that have to be made," says Elkerton. "Under Chapter 11, we would be advisors to the Board; we wouldn't be able to force change, and creditors' funds would be at greater risk."

O'Neill, too, agrees it is all about power. He is not recommending a straight-up adoption of Chapter 11, but rather a hybrid that combines the best of Chapter 11 with the best of our system. The power should go to a Turnaround Panel - modelled on the Take Over Panel, a regulatory body that administers takeovers and mergers.

"The Take Over Panel stops legal action during takeovers," says O'Neill. "Under Chapter 11, power goes to the Courts and a panel of judges is in control. If we had a Turnaround Panel, the courts could cede power to a panel of business people, skilled in turnarounds."

This would change the dynamic of the law, according to O'Neill. Instead of business owners holding on for grim life, maybe they would seek help before it was too late. He says such a change would not only trigger a change in culture, it would herald the creation of a turnaround industry.

LAW OF THE JUNGLE

Peter Allen, executive chairman of Allen Capital, disputes the idea there is no turnaround industry in Australia. The bulk of Allen Capital's work is dealing with business turnarounds, including distressed companies. Allen's Special Situation Fund is purpose built for restructure and turnaround situations.

"It is rubbish to say there is not a turn-around industry, because it is happening all the time. Profitable businesses with negative trends, unprofitable businesses with lots of assets and unprofitable businesses with no assets are all in need of turnaround," says Allen.

The market takes care of most turnarounds. Foundering listed companies start by shedding directors and executive teams, and are ultimately taken over or broken up. Private companies seek new capital injection – and new stakeholders often bring a management shakeup with them.

Allen points out that there are companies that specialise in buying control of underperforming businesses and turning them around. The mechanism of the market itself is a turnaround industry, as the very nature of our economic system is focused on the allocation of scarce resources. If a company is in trouble, it will be consumed by someone who can see a better use for the resources that company is using.

"We have a market clearance system," says Allen. "Companies must report their results, analysts write about it, people get sacked, a takeover happens and the problem disappears."

CHANGE AT THE BANK

The role of the banks is also misunderstood, says Allen. "Fifteen years ago, banks would say – 'put them into liquidation and get our money back'. Now the banks have portfolio management groups that work with owners in an informal environment to turn around companies."

Banks are able to do this because of Australia's existing system. As secured creditors, banks have a great deal of power over distressed clients – power they would not have under a Chapter 11 regime.

"The banks act as catalysts behind the scenes," says Allen. "They give a company the names of three turnaround consultants and tell them to pick one."

Allen agrees with O'Neill that improvements could be made. First, he says, there does need to be increased flexibility in regard to time given to negotiate a way forward, especially where large companies are concerned. Second, a debtor-in-possession financing market modelled on the US system could be introduced. Here, a company under administration could access finance from a third party other than existing creditors.

Some companies do fall through the cracks, notes Allen. These companies are distressed, with no

profitable business and few assets. They have few options - of which voluntary administration is probably the best.

“Business turnaround is quite a romantic concept,” says Allen. “But the cold hard facts are that once a business is distressed, the prospects for a restructure aren’t great.” It’s a debate about culture, not the law, after all.