WORK-OUTS

QUESTIONS AND ANSWERS

Question - Denis Clifford (Buddle Findlay, Wellington):

I have a very specific question for Jonathan and that is whether any of the remedies which he has spoken of today or the procedures affect creditors' rights of set-off against a company?

Response - Jonathan Horsfall Turner (Speaker):

I think the answer to that is that in some cases yes, creditors' rights as far as set-off are concerned can be affected, and one of the things that I did not have time to talk about today are in fact the new rules that have just come in, which I think I referred to at the end of the synopsis, are related to financial markets and insolvency regulations under ss154-191 of the 1989 Companies Act, which actually override some of the provisions relating to problems for set-off etc in relation to contracts on international markets, and in particular the London markets which have been brought into being in order to give effect to the ability to set off for commercial expediency in those markets. I think the whole area of set-off and the Insolvency Act is something which we are going to find is an increasing problem and something that may well require quite a bit of further legislation in future.

Comment - Peter Fox (Mallesons Stephen Jaques, Melbourne):

First of all on subordination, one of Jonathan's partners, Philip Wood, has a marvellous book which he was kind enough to send us in a hurry last year and I commend it to everybody. John Cadell, one of the issues you did not focus on was the impact on subordinated debt of the behaviour as between senior and subordinated creditors and whether or not that could affect the subordination. That is to say whether or not there might be fiduciary obligations owed, whether or not those sorts of things which might discharge a guarantee may also discharge subordination, that is apart from any other claims that are made. There may be circumstances where the subordination is no longer effective if ever it was. That is the first issue which I will throw back to you, John Cadell. The second one is, I have very grave difficulty in disagreeing with John Cadell's comments in terms of the committee structure for work-outs. It seems to me that immediately the financial adviser is seen to be part of the banks' interests, there are very serious issues involved, if only because the banks indemnify that financial adviser, but in addition to that it would seem to me that the whole concept of the work-out on the so-called ***Ariadne*** model which has been modified in a lot of ways is that the financial adviser is put in there to be a representative of the company - albeit a disinterested one - but certainly not to be a narrow representative of a bank interest. I think once that second representative position is taken, the banks are at very grave risk of being held liable in some of these things.

Response - John Cadell (Commentator):

Peter, on the first point I agree. I don't know that I can add anything. On the second point, I am not saying that the person who chairs the bank committee is a financial adviser fulfilling the same roles as the more traditional financial adviser. There have been cases in which a company has had both, and one case in which they were partners. But I think in those cases where he has acted as chairman of the bank group there has been an attempt to spell out his duties in a way which makes it clear or attempts to make it clear, and no doubt the draftsmen have succeeded, that he does not owe duties to the company, they are to the banks. I think you can probably document that in a safe fashion. My concern more is that you have got so much muscle on one side of the table that if the facts on the other side are that the people have really got their hands tied behind their back, then I don't know - it is hard to imagine why they are not directors. As I say, it is a question of facts. I think it is just a bad starting point and it is certainly a very bad thing to follow I should have thought.

Question - Bob Baxt (Trade Practices Commission, Canberra):

A question to Jonathan and I would be interested in John Cadell's comments. As I understand it in England now we are seeing law firms acting as receivers under the changed rules which enable lawyers to do the kind of work that accountants have been traditionally doing. Of course, in the United States lawyers tend to do most of this work and I understand in Europe that is the situation as well. I was wondering Jonathan whether as we are likely to see some change, the Harmer Committee certainly recommended that the issue be addressed and I know that our own Commission has raised that in relation to our study of the accounting profession, I wonder what your views are about lawyers being involved in this kind of work, especially if we are going to see it widened to the kind of situation that you are discussing. And John Cadell, I would just be interested in your comments on that.

Response - Jonathan Horsfall Turner (Speaker):

I am all in favour of more work for lawyers and one can also say that accountants on the whole have had their go at getting work that has traditionally been lawyers' work over the last few years - so I don't think we need to be shy about stepping into an area which perhaps traditionally has been the preserve of the accountants. However, as a practical matter, you will find that I think we have two or three of my partners who are qualified insolvency practitioners, but under no circumstances would they in fact consider acting as administrative receiver or administrator under the Insolvency Act. The reason for that is, again from the practical point of view, and it is purely a question of commercial expediency, that most of our work in that area and I think most of the other major law firms who have considerable insolvency reconstruction practices as indeed we now do, is that the majority of that work is in fact referred to us by the accountancy firms. And if we once start acting as insolvency practitioners, then I am quite sure that that flow of work will stop. Now that may be a rather cynical view of what the ideal position should be, but nevertheless I think the insolvency partners in our partnership are very happy to be able to hide behind the insolvency practitioner and to continue to have him coming from one of the main firms of accountants.

Response - John Cadell (Commentator):

Bob, I would just say that I think that it would probably be OK, so long as the lawyer when acting as an insolvency practitioner has the good sense to go and hire separate lawyers to act as lawyers. I mean it is the same philosophy as having a company have

its principal solicitor sit on a board, and it seems to me the height of folly. Even if lawyers could do it, I think that they are basically doing administrative tasks and they should not try and give legal advice to themselves on the run. So I would see it as that there is certainly no need for it and certainly nothing to be gained from it.

Question - Peter Hedge (Coopers & Lybrand, Sydney):

It is interesting to note that there is a bit of a love-hate relationship with banks in relation to administration orders. The work-outs and the frustrations of banks in Australia have been more due to the inadequacies of their securities etc in trying to sort out the problem. And therefore, an administration order would suit them, but those banks that do have security, particularly in the UK when the administration order is being introduced, felt that it was quite an invasion on their rights as secured creditors. The fact that the court could come in and start putting them in their place. So I wonder whether some of the criticism or the criticism levelled at insolvency law in Australia at present or the frustration is not in fact the lending practices and the way in which the loans were structured initially by the banks, without fully recognising the risks that they were putting themselves at by negative pledge or unsecured lending to large corporate conglomerates rather than actually a deficiency in our laws. I wonder if perhaps Jonathan could just comment. My understanding is that there remain, even though there is an administration order available in the UK, work-out committees for some large corporate conglomerates. Could you confirm, Jonathan, your understanding, the fact that the administration order is just another tool in the array that is available to sort out problems - it isn't really the answer in itself?

Response - Jonathan Horsfall Turner (Speaker):

Yes, in short I think I can certainly confirm that. I think I have said it is not the panacea for all ills, it is just a further tool of flexibility and part of the choice process. And coupled in with that I think also I said that because of the ability of banks to achieve greater control and to perhaps take new security and to watch that harden if possible, that most banks that I know and work with would certainly go first for a contractual rescheduling. And really, administration is viewed as the end of the road. I don't really think that if there is a possibility of a normal bank rescheduling - I say normal bank rescheduling and there isn't a normal bank rescheduling - but on the basis that a rescheduling might be achievable, I think that any company and its bankers would try to go for that. If I can just say that in relation to for instance even Polly Peck that at the first meeting of the banks at which there were over 80 present and there was an incredible lack of information, but everybody was trying to put together a bankers' committee which did in fact meet for about three weeks and it was only when people really realised that the company was effectively - not actually close to liquidation because obviously an administration order was actually obtained, but certainly that things were in a position that the best one could hope to get out of it was to realise at a better price some of the assets rather than to actually see the company continuing on an on-going basis that one actually went into administration. Once one went into administration the talking period was over. Everything was over to the administrator and basically you were into a totally new realisation phase. So, yes, I confirm that absolutely and there is no doubt that a strong creditors' committee with some strong co-ordinating banks have a far greater possibility of achieving an on-going viability for a company, albeit maybe a slightly painful process for all concerned including the lawyers on the way you get there, but nevertheless I am sure that that is their preferred route and one which will continue to be so, certainly under our current legislation.

Comment - Gregory Burton (Barrister-at-Law, Sydney):

This is more in the nature of a commercial than a question or asking for comment I think. It is in relation to a topic which is becoming, obviously from what John Cadell says, a particularly controversial one and it is one that some of you may have seen and many of you would subscribe to a journal known as the "Journal of Banking and Finance - Law and Practice" which I have the honour to edit and many of the people in this room have the honour to contribute to or be on the board. In fact we have a very intensive series - it is a three-part article on equitable subordination of lenders' claims - over the next three issues. We also have - and this is not a s52 liability representation I hope - that I think that Terry Taylor and Peter Walker who are writing in our liquidation and insolvency management section, may be working up to doing a series on work-outs. And that brings me to a final thing which is just a general plug in the sense that there are some issues in the last two copies of the journal out on the table in the entry foyer, and the last issue contains a preview of what is going to happen over the rest of this year and in fact the next issue of the journal which is in the first week of June will be the first one in which we welcome New Zealanders as regular commentators and members of the editorial board and in fact there is an extensive commentary by Mark Russell on the Companies Bill which has been discussed this morning. And so I would encourage you, and I assure you I get no commission from this, but I would encourage you to consider subscription to the journal.

Comment - Roger Drummond (Chairman):

Ladies and Gentlemen. Before thanking the speakers; Jonathan's comments about more work for lawyers as potential insolvency practitioners has reminded me of the story of the lawyer's secretary who discovered a major plumbing break in the kitchen in her offices. There was water squirting everywhere. She immediately rang the plumber - and I don't know if the situation is the same in Australia as in New Zealand - but, two hours later and with a lot of water flowing down the liftwell, the plumber finally arrived. He managed to effect repairs in about five minutes and then presented to the secretary an itemised bill for quite a considerable sum of money. There was a break down which included travelling time, dirt money, tool money, and three or four other categories. Well, she thought she better check with her employer before paying the bill. When the lawyer saw the account he nearly dropped dead and said: "Good heavens above". He had a word to the plumber and said: "This bill is very expensive, even I don't charge that amount on an hourly basis." The plumber turned round as quick as a flash and said: "I know. Neither did I when I was a lawyer.

Ladies and gentlemen, on your behalf I would like to thank Jonathan and John for their illuminating comments and in particular I would like to thank Jonathan for going to the trouble of flying such a long way to address us and on such an important topic as insolvency law reform. I think the Association might start to run a sweepstake as to when some insolvency law reform does occur in this part of the world. I think the important thing is and the point that we are concentrating on is that the law must be drafted in the right way to respect the appropriate balances. Jonathan, thank you for your illuminating input on the UK scene and also the Irish scene. On your behalf I would like you to show your appreciation in the normal way.