Law Council
OF AUSTRALIA
Business Law Section

Senate Standing Committee on Economics
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18 March 2016

Dear Sir or Madam,

Submission in response to the Senate Economics References Committee Inquiry into the causes and consequences of the collapse of listed retailers in Australia

This is a joint submission by the Insolvency and Reconstruction Committee and the Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committees**) in response to the Senate Economics References Committee inquiry into the causes and consequences of the collapse of listed retailers in Australia, as referred to the committee on 4 February 2016.

The numbering below follows that of the terms of reference.

1 Conduct of private equity firms prior to, during and after corporate takeovers

The involvement of private equity firms in corporate takeovers, particularly takeovers of those entities which are viewed publicly as "household names", often generates considerable media attention – perhaps nowhere more than in the retail sector, which has been an active sector for private equity investment over recent years. To mention some domestic examples, aside from Dick Smith, the following have at some stage been owned (partially or fully) by private equity firms: Myer, Kathmandu, Lorna Jane, Rebel Group, Pacific Brands, Colorado, Borders and Angus & Robertson. Despite this media attention, and the level of interest by private equity firms in the retail sector, the view of the Committees is that there is no particular cause for concern regarding private equity firms which suggests the need for any specific law reform.

In terms of the retail industry in particular, its cyclicality, structure, sensitivity to the broader economic climate (both domestically and offshore) and consumer trends, are presumably some of the factors which attract private equity interest to the sector – but equally, are factors which the Committees suggest have similarly led to corporate failures in the sector. In this regard, the Committees consider that there is no indication that takeovers of listed retailers by private equity have themselves caused corporate failure.

To the extent that there has been the suggestion that private equity exits through IPO may have caused corporate failure, then (although the Committees have not performed

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specific investigation or analysis with respect to those failures) those corporate failures may well have arisen as part of the risks of business which the company structure generally was established to allow to be taken so as to encourage entrepreneurial and business activity.

The Committees do not consider that there is anything unique about the failure of listed retailers which puts them in a separate category requiring any specific regulatory response. If there has in fact been any inappropriate conduct which has caused those corporate failures, the Committees would expect the existing corporate law rules which have been developed over time (the disclosure and liability regimes for takeovers, fundraising and continuous disclosure to the market, and misleading and deceptive conduct rules) which apply across all industries and to those participants in them – private equity or otherwise - to be sufficient to address that conduct.

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

ASIC and the ACCC each play a vital role in corporate takeovers generally – and their role is consistent regardless of the industry sector. In this regard, the Committees do not consider that there is any particular indication of failure by ASIC or the ACCC in relation to corporate takeovers in the listed retailer space, or that ASIC or the ACCC should be directing additional focus towards that sector.

It is not the role of ASIC nor the ACCC to assess the corporate merits of a corporate takeover, nor – at the other end of the cycle – an IPO. In the case of IPOs, ASIC is however, concerned to ensure that there is a balance between the disclosure of the potential benefits and risks attaching to shares offered under an IPO (see for example, ASIC's prospectus policy in its *Regulatory Guide 228 – Prospectuses: Effective disclosure for investors*).

In the past there had been some concern that, when a "household name" like a prominent retailer was undertaking an IPO, investors may be influenced or distracted by the familiar photos and imagery in the prospectus, to the exclusion of the description of the features and risks of investment in the retailer company. A specific impact of RG228 was to lessen the prominence of photos and imagery and to ensure that the balance between potential benefits and risks of the relevant shares was appropriate. If the risks were appropriately described in accordance with ASIC policy and applicable legal requirements, then the corporate failure, however unfortunate, should not trigger a regulatory response. If they were not, the laws and existing ASIC policy should be sufficient to redress any inappropriate conduct which may have occurred.

In terms of takeovers, the prescriptive requirements in the *Corporations Act 2001* (Cth) in relation to bidder's statement disclosures require detailed information in relation to the bidder and its intentions for the target – including, the continuation of the business of the target, any major changes to the business of the target (including any redeployment of fixed assets) and the future employment of present employees. In June 2013, after industry consultation, ASIC released its updated regulatory guide on takeovers (RG 9). That regulatory guide contains greater specificity as to ASIC's expectations around bidder's statement disclosures including, the bidder's intentions for the target. If ASIC is satisfied that a bidder's statement complies with the Corporations Act (from both a technical / procedural compliance and disclosure perspective) as well as its own policies, then it is the view of the Committees that ASIC will have performed the functions which are appropriately placed on our corporate regulator to oversee corporate takeovers.

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

External administration places an independent expert in the form of a liquidator, receiver or administrator in charge of the management of the company. Liquidators and administrators have legal duties to act in the interests of all creditors and must strive to generate the maximum returns to creditors while complying with a range of regulatory investigation and reporting requirements. Privately appointed receivers have a paramount duty to protect the value of the collateral covered by the security but do have a legal duty to sell the asset for the market price and must act as an officer of the company with a duty to act in good faith and for a proper purpose as well as to act with due care and diligence.

Exercising management powers may involve the decision to cause the company to breach one or more pre-appointment contracts as this may result in a better return to all creditors. The ability to make this decision is not particular to external administration. A solvent company can elect to breach a contract and will be liable for compensation, just as a company in external administration will be liable to compensation.

Employees are particularly vulnerable to the insolvency of their employer and this is recognised through the *Fair Entitlements Guarantee Act 2012* (Cth) which provides a statutory regime to pay employee entitlements where employees lose their job due to liquidation or bankruptcy.

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

By necessity, the insolvency of a company brings with it quite severe commercial and economic outcomes. Usually administrators are appointed by directors of the company to comply with their duty to avoid insolvent trading. So the insolvency, rather than the appointment of administrators itself, is what causes the detriment to creditors.

The role of voluntary administrators is prescribed by the Corporations Act. They owe a clear duty to act in the interests of creditors.

Unfortunately, corporate failure inevitably causes loss to creditors – who can include gift card holders and customers who have made deposits on goods not delivered. Sometimes administrators will conclude that it is consistent with the interests of creditors to honour gift card holders and those who have made deposits on goods not delivered, as part of preserving the goodwill of the business to seek the best outcome for creditors overall.

In circumstances where taking those actions is not in the best interests of creditors, it is likely that there is a very substantial shortfall, in which case, unfortunately, all unsecured creditors, including (for example) small business trade creditors as well as gift card holders and customers who have placed deposits, will lose money.

5 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

The conundrum that arises with the proposals put forward in the terms of reference is that assisting one group of stakeholders will necessarily come at the expenses of others. The Committees do acknowledge the particularly unfortunate timing of the collapse of Dick Smith – shortly after the festive period, which might reasonably be expected to be a time when the sale of gift cards was higher than normal.

5.1 Placing an obligation on external administrators to honour gift cards

While it is unfortunate that gift card holders lose money in an administration, in circumstances where a business imperative to preserve the goodwill of the business does not drive the administrators to honour gift cards, there is no reason to prefer holders of gift cards to, for example, small business trade creditors.

The role of administrators is a difficult one - they already face formidable challenges in trying to maximise the value for creditors in a distressed situation, and to impose additional obligations and restrictions on administrators in terms of how they manage the business of any insolvent company would, the Committees expect, make that task even more difficult.

To look at the issue from another perspective, there is no reason to distinguish between the situation where an administrator has been appointed and the position where a secured creditor has appointed a receiver – who is (rightly, in view of the broader economic objectives of our corporate insolvency regime and how it deals with security and priority as between categories of creditors) under no obligation to honour gift cards.

5.2 A requirement that funds used to purchase gift cards be kept in a separate trust account by businesses

The Committees submit that the administrative burden of managing such an initiative would be counterproductive. Specifically, introducing substantial additional red tape and related cost over what will often be a multitude of relatively low dollar value transactions would not be justified to address this very specific category of potential stakeholder – gift card holders – recognising that the vast majority of retail trade is undertaken by solvent companies which honour gift cards on a daily basis.

The Committees would also be concerned about the ongoing policy implications of an initiative such as this. For the reasons mentioned above, there is no sufficient policy reason to differentiate between gift card holders and other categories of creditors. For example, while a person who received a $100 gift voucher for Christmas which is not honoured will of course be disappointed, a small business supplier who is not paid a $10,000 debt may have its own business fail as a result, which is economically devastating to that small business and will, in turn, have flow-on effects to creditors of that small business which are not paid in full.

5.3 Directors to be personally liable for the value of gift cards purchased

Similar to the comment made in 5.2 above, the Committees would be particular concerned with the flow-on policy implications of this proposal.

In comparison to the rest of the world, Australia's insolvent trading liability regime imposes the most onerous obligations on directors. As the Productivity Commission has recognised, it already imposes too great a burden on directors. The Committees' view is that there is no legitimate policy reason in relation to gift cards which would warrant imposing additional bespoke liability on directors for this narrow sub-set of creditors.

To impose this onerous obligation on directors would likely produce the pragmatic effect that less retailers would offer gift cards. This would be detrimental for both retailers and for consumers, having regard to the fact that the vast majority of gift cards are honoured without complex trust arrangements or a specific director liability regime being imposed. Retailers would lose an important source of revenue. Many consumers value the ability to buy gift cards for a range of reasons, from being time poor in an increasingly busy world,

lacking confidence to choose a gift for someone of a different generation to just wanting to avoid the risk and disappointment of choosing a gift which transpires to be unwanted.

The Committee would be pleased to discuss this submission if that is helpful. Please contact the Chair of the Corporations Committee, Rebecca Maslen-Stannage.

Yours faithfully,

Teresa Dyson, Chair

Business Law Section