Parliamentary Joint Committee on Corporations and Financial Services

Inquiry into Corporate Insolvency in Australia

KPMG responses to Questions on Notice, hearing 21 February 2023

1. Corporate Insolvency – airlines

Question 1:

Finally, what was different in the Virgin and Ansett cases in terms of the way that the law operated?

Response:

KPMG Australia (KPMG) was not involved directly in either of the Virgin or Ansett voluntary administrations (VAs) and therefore our reflections are based on industry observations only.

Both the Ansett and Virgin Airline cases were VAs under part 5.3A of the Corporations Act. The Ansett VA was undertaken in 2001/2002 and Virgin in 2020/21 almost 20 years apart.

In both cases the Administrators:

- were able to continue the operations of the airlines for a limited time in order to pursue a going concern sale of the business;
- were able to obtain some funding for continued loss-making operations – in Ansett's case via a settlement with Air NZ and in Virgin's case via a bridge loan from the eventual buyer;
- could quickly negotiate a sale of the main elements of the business;
- applied to the Courts under s.447A of the Corporations Act for the variation of certain provisions of the VA laws to assist in the Administration (s.447A allows the Court to make any order it thinks appropriate about how the Voluntary Administration provisions operate in relation to a particular company or situation). Specifically, the Courts gave the Administrators more time to deal with leased assets than is normally allowed which is important given both airlines leased aircraft critical for continuing operations;
- were granted certain leeway in relation to creditor notifications and meetings - in Ansett's case to save cost and in Virgin's case to navigate the practical difficulties associated with COVID-19.

The Administrators of Virgin went a step further in requesting the Court to relieve them of personal liability for debts incurred in the Administration. While the Court described this application as extraordinary, it ultimately granted the order sought having regard to the circumstances confronting the Administrators, the impact of the COVID-19 pandemic, the national interest (Virgin being a major airline serving the country) and the benefit to the economy from suppliers continuing to trade.

The differing outcome in the two cases was due to a multitude of factors but ultimately came down to whether sufficient funding was available to the Administrators to meet the losses being sustained by the airline during the time taken to complete a sale of the business. In Ansett's case there was insufficient funding to trade for the time required to complete the sale whereas in Virgin's case the funding was sufficient to conclude the successful sale.

The reasons for this are complex but there are three factors which influenced this outcome including:

- Virgin entering Administration at an earlier stage while it still had cash reserves available;
- the emergence, since the Ansett case, of a vibrant private equity and alternative capital market, willing to both fund an Administration during a sale process and to compete for the acquisition;
- the willingness of the Courts in the Virgin case to provide great flexibility to the Administrators under s.447A of the Corporations Act in relation to (a) their personal liability for debts incurred and (b) in their dealings with aircraft lessors.

2. Sub-contractor retentions

Question 2:

Could I ask you to consider that, in light of evidence that was put to us this morning about the need in the construction industry for money to be held in trust, rather than to be used as the working capital of tier 1 companies? The secretary will provide a little more information about that. I am interested in what the cost of such a structure might be, given our new technical capacities, as opposed to just ruling it out as a cost too far. It would provide incredible security based on the evidence we received this morning.

Additional information provided by secretariat:

The committee secretariat understands that the evidence from earlier in the day, that is being referred to, is predominantly from:

— Incolink on employer entitlements schemes;
— CFMMEU on subcontractor retentions.

Response:

KPMG makes some general observations in relation to this matter, noting that we don't have significant direct expertise in this area.

Protective Employee Entitlement Schemes

KPMG understands that several schemes exist in Australia which seek to create a fund for the payment of employee long service leave and/or redundancy payments for contractor employees working in the construction industry. These are essentially insurance or investment type schemes which seek to create a safety net for workers being made redundant. Contributions or premiums are paid by employers or employees.

While these schemes undoubtedly protect some employees in some circumstances, they are not directly linked to leave or actual redundancy obligations of employers and so unavoidably add some additional cost to the employees or employers involved.

The cost benefit of such schemes must be assessed by the employees and employers participating.

Subcontractor Payment Trust Schemes

These schemes exist currently in Queensland having been established and introduced progressively from 2021 to 2023. They broadly require head contractors on significant projects to establish trust accounts into which project owners pay their progress payments. The head contractor must pay subcontractor invoices out of these trust contracts before paying their own costs.

While these arrangements are likely to give greater protections to subcontractors, they do rely on the head contractor understanding and fulfilling their role as trustee of the trust. The arrangements can also impose significant additional costs into the building process. These additional costs fall into two broad categories:

- Administrative costs of establishing, maintaining, and operating the trust accounts by the head contractor, including internal administrative costs as well as external legal, accounting and auditing costs; and
- Costs of additional working capital required to be maintained by the head contractor to operate its business pending release of its funds from the trust accounts.

The real-world experience in Queensland over the next few years will be good evidence of whether such arrangements are workable and whether they represent a cost-effective mechanism to protect subcontractor payments in the industry.