LEGAL SYMPOSIUM
AUSTRALIAN FRANCHISE CONFERENCE
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Panel Session – Franchises and Insolvency

1. *Explain the differences between the Australian and New Zealand insolvency framework.*

    1. Lack of regulation in New Zealand;
    2. No really meaningful uptake of the voluntary administration régime in New Zealand which means that receiverships and creditor compromises are still favoured in New Zealand but not as much in Australia; and
    3. Privatisation of personal bankruptcy administration in Australia whereas in New Zealand it devolves upon the Official Assignee to carry out those engagements.

    In New Zealand the Insolvency Practitioners Bill is currently before Parliament and it has been at the select committee stage for a long time. In Australia you need to be licensed to be a liquidator or Administrator or receiver whereas in New Zealand the regulations are virtually non-existent (see Companies Act section 280). In essence, you can be a liquidator, subject to certain very specific exclusions, if you are over the age of 18, are not currently bankrupt and are not insane. As a consequence of the lack of regulation in New Zealand, all manner of dubious operators have emerged and there are presently two individuals who have spent time in prison on fraud or related convictions. In Australia the licensing régime requires practitioners to have certain academic qualifications, minimum specific work experience under the mentorship of an already-licensed professional, evidence of PI cover etc. The obvious shortcoming in New Zealand is that a rogue practitioner who is not a member of the Law Society or Institute of Chartered Accountants is subject only to scrutiny and censure by the High Court. What is being proposed is that there will be some sort of registration process required when the Bill becomes law and that under that process there will be a *"3 strikes and you're out"* policy. However, there seems to be very little detail on what the registration criteria are going to be and who is going to do the actual policing of the process. In Australia it is ASIC and logically it should be the FMA in New Zealand but that has not yet been decided. In short, the lack of regulation in New Zealand makes the insolvency profession something of a pot luck and we all rely on the market to sort the wheat from the chaff.

    For a variety of reasons (including the lack of regulation) voluntary administration has not been nearly as successful in New Zealand as it has in Australia. In New Zealand the emphasis is still on receiverships as a means of enforcement and of course the focus in a receivership is seldom on rehabilitation, rather it is on getting the secured creditor their money back. The New Zealand banks do not really like it and the retention of Crown preference regarding unpaid GST, PAYE, etc makes it a difficult product to sell. That said, there have been a few successful voluntary administrations and one can only hope that in the fullness of time attitudes will change and the régime will be more widely applied with positive outcomes.

    In Australia certain licensed practitioners also hold licences to act as personal bankruptcy administrators; in New Zealand that role is filled exclusively by the Official Assignee.

The Official Assignee does a very good job but with limited budgets and resources it often does not pursue errant bankrupts as robustly as a private practitioner might. In Australia those who do hold bankruptcy licences often get very good results for creditors of bankrupts by pursuing their trusts and delving into their backgrounds. Private practitioners may have better resources than the Official Assignee which could lead to better outcomes for creditors.

2. *What are the general trends in insolvency in New Zealand over the last 12 months?*

Practitioners were very busy between late 2008 and early 2012 but as the general economic recovery started and the failed finance company legacy was cleaned up there was something of a decline in large insolvency engagements. I spoke to an insolvency practitioner in Auckland and he said that there is still a steady flow of work, it seems to be across the board and there is no one sector that is performing particularly badly at present. Retailers have definite challenges and manufacturers/exports are contending with a strong dollar and high costs so they are under some pressure. The hospitality trade is doing it tough and there have been several bar and restaurant closures, usually driven by the breweries who are calling in their loans. Property remains a challenging sector (apart from the Auckland residential market and the Christchurch rebuild) and a number of banks still have some rather distressed properties they are carrying on their balance sheets. The banks have taken a very measured and pragmatic approach though, preferring to work with clients who are in distress as opposed to simply calling in the receivers. Where they have difficulty managing the files internally they are tending to get specialist advisors to do investigative reviews to provide an independent assessment of the future viability of the business. The banks have generally been very reluctant to go to the extent of appointing receivers unless there is no alternative. However, they generally favour receivership ahead of voluntary administration unless they can be convinced to the contrary.

3. *If a franchisor is in financial stress and cannot pay its bills what steps can you take? What are the options for the franchisor?*

Typically the best solution is to try to go into a voluntary administration to save the business or to otherwise compromise with the franchisor's creditors via a formal scheme of arrangement (Part 14 of the Act). If the franchisor fails and goes into liquidation or receivership, there will primarily be an effort to sell the franchise to another operator but if that is unsuccessful then it leaves the franchisees open to considerable risk themselves. The emphasis on remedial mechanisms working though is the timely intervention of insolvency or business recovery specialists and the franchisor arguably has a duty to the franchisees to seek assistance before it becomes too late. The options are therefore to call in a recovery specialist to seek to save the business through re-engineering it or possibly through a further capital raising but if that does not work then they can go into liquidation voluntarily or wait for a creditor to petition the Court to appoint a liquidator. Of course there is always the prospect that the bank or other secured lender will appoint a receiver.

Assuming the bank has a secured position it can of course appoint a receiver under its security documents. However, as mentioned earlier, the banks have taken a very measured and pragmatic approach, preferring to work with clients who are in distress as opposed to simply calling in the receivers (which action may be taken only as a last resort). They will work with the franchisor utilising their own internal recovery team personnel but may call in an external specialist to oversee a re-engineering process which is usually preceded by some sort of an investigative review. Where the bank has lost confidence to the point where they want a quick exit they will then take the step of appointing a receiver who will typically seek to sell the business as a going concern as the first option. An external specialist would possibly look to one of the better performing franchisees as being a potential purchaser of the franchise, or a competitor.

4. *If a franchisee is in financial stress and unable to pay its debts what steps can the bank take? (This is assuming there is bank finance and the bank has a General Security Agreement registered on the PPSR.)*

A franchisee will have executed a GSA in favour of the Bank and provided personal guarantees. There may also be a registered mortgage over real estate. If the franchisee company cannot pay its debts then the Bank may assist with overdraft accommodation or it may appoint a receiver or, if the case is hopeless, the company will go into liquidation. The Bank will enforce its security including the right to sue the personal guarantors. The franchisee should inform the franchisor at the earliest opportunity as often franchisors try to assist and may have some clout with the Bank. Inability to pay debts is serious and the problem should not be ignored.

5. *If I was acting for a franchisor and one of their franchisees goes into voluntary administration how would I advise the franchisor?*

The emphasis in a voluntary administration is on rehabilitation rather than shutting the business down. If that is to work and a Deed of Company Arrangement is to be put in place seeking to continue the ongoing operations, the franchisor would need to make a very rapid assessment as to whether it wanted to support the franchisee and work with it to see its financial health restored or whether the franchisor deems it appropriate to *"pull the plug"* in the interests of preservation of the brand and the rest of the franchises and the system. There would need to be a very rapid assessment and a lot would depend on the documentation. However, generally the voluntary administration period lasts for 25 working days and in that time there is a stay of all actions against the company except that a creditor with a GSA can exercise its right to appoint a receiver within the first 10 working days. It may thus be impossible to *"pull the plug"* right away but if there is no confidence in the franchisee going forward it would probably be prudent for the franchisor to vote against any proposed rescue package and after the watershed meeting terminate the franchise agreement. The Administrator would need to have a serious discussion with the franchisor very early on because without ongoing franchisor support there is not likely to be a business to rescue anyway.

The advice a professional advisor should be giving should be based on the confidence which the franchisor has in relation to the capability and prospect of the franchisee being restored to profitability and that there is no danger of reputational or collateral fallout for the brand.

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