Talking Law

Episode 123 – What to do when the business goes bad: navigating tough discussions with a liquidator

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Transcript

Joanna: Josh, thank you so much for joining us today on Talking Law, it's great to have you on the show.

Joshua: Well, thank you for having me. It's exciting to be here.

Joanna: Fabulous. Okay, now look, I really wanted to drill into this concept of when things go bad for an organization. And I love stories. So I thought it'd be great if we had you on the podcast talking about what it looks like when things go bad, and then maybe even some tips and tricks for our listeners as to the things that they can do, I guess, to help ward off issues or identify them early enough. So maybe kicking into it, I guess, what, why are we talking about this topic Josh? I mean, obviously, you see day in day out that the sad stories of where things have gone wrong in a business, and that have ended up exploding. And so you've obviously seen a lot of themes that come up again, and again and again, in that sort of story.

Joshua: Yeah, so the main themes in terms of micro-businesses, small businesses in the personal space, are relationship breakdowns, divorces, which can often lead down the path of financial instability, gambling, lifestyle issues, and just laydowns in businesses, which can't be matched by a slowdown in lifestyle. So they're the four main ones. And then the people you see who are owed money at the end of that is you always see lots of ATO debt, you see lease debts, on leases, with a personal guarantee, and all that sort of stuff. You see debt to the major four banks for personal loans, credit cards, and other lenders, where oftentimes people keep getting more loans to pay off old lines, and they just end up in a bit of a circle of debt.

Joanna: Yeah. And sorry, just to stop you for a second, you sort of talked about micro and super small business, but many of our listeners, and our clients are sort of around that mid-size, SME as well and quite often large SMEs and presumably, well, I guess you tell us, do you see more of the micro than the, you know, mid to large SMEs in financial difficulty or are the mid to large, you know, SME still is exposed, but just in different ways.

Joshua: Definitely. So the more successful you are probably the more exposed you are. Because Yeah, the exposure to financial difficulty comes from people who have money going out at a higher rate than money coming in. And oftentimes on the micro-scale, or on a smaller scale, people are pretty disciplined with their budgeting to take it to the extreme end, people who are on some sort of welfare system, they know exactly how much they're getting each week, and they pretty much spend the same amount each week. So it's, you don't fall into as much difficulty there as what you'd expect. It's when you are running a smaller business, you might have a turnover of 1 to 5-10 million dollars, and that turnover goes down. And so those reasons are still the same reasons. The first major one again, it's more businesses, it's usually driven by someone that might be driven by Joanna Oakey, might be driven by Josh Taylor might be driven by Bob Smith. But if that Bob Smith, Josh Taylor, Joanna Oakey has a relationship breakdown, they don't have their mind on the game. And all of the things that drive business through both getting businesses working on the business and getting the customer satisfied out the door starts falling to pieces because our mind is elsewhere.

Joanna: I totally agree. And the other thing that we see is that when you know, we're talking here about the relationships of the individuals outside of the business, we quite often see relationships of individuals within the business. So say, for example, business partnerships, so you know, where there's a breakdown within the business that can really have an impact on performance. But the other thing that I see that, that I often find trumps everything else is fast growth. I feel that fast growth is actually one of the most vulnerable periods for businesses that we see. because quite often there's this mismatch in the understanding between revenue, profit and cash flow because it's that cash flow that as they're growing really quickly, can be really caught up and can cause massive problems. Is that something that you also see as an issue?

Joshua: Yeah, so definitely if people don't have strong advisors behind them, and people are afraid to reach out, that does happen. Usually though, with strong growth, you're in a better position than people who are going the other way. So say, for example, you're better off being the Uber than the Taxi Driver, so the taxi driver has just had his market reduced 70% better off the Uber guys taking 70% of that market. So it's just a matter of perspective. But certainly, there are traps with people where they think, okay, I'm just on my first $5 million contracts, I'm gonna go spend $5 billion

today. And then they spend that money, and then they've got to keep recurring, they don't have other contracts. And then they just didn't want to pay

Joanna: Exactly, and particularly where that contract that's worth 5 million, because that's such a good example. Because it can sometimes be these really large contracts that contract where you know, there might be 5 million, the actual turnover of that cash is very slow. Say, for example, the client stops paying or is very, very slow in paying, and you've had to pay out, you know, a lot of your expenses along the way. So I guess they can be these cash crunches, from what looks to be like a great event. Do you know what I mean? If you've not got your right, if you're not used to growth, so maybe let's reflect on some of those stories that are most memorable for you, Josh, for where things have gone bad? What are some of those examples that you've got that really stick out clearly in your mind?

Joshua: Okay, so since caching growth is, is the number one talking topic of where we're going, I recently had a client who is in the IT space, doing contracts for other larger companies, which everybody would know, in the software, marketing, internet type space without giving away any names. And they had very large contracts, and they were growing really fast. But the problem they had there is a fundamental misunderstanding of both how you pay your employees when you pay your employees, you've got to pay gross wages, not just what cash goes out every week, or every fortnight and misunderstanding of the value of yourself, and what are these customers purchasing. So this individually, he got started getting some good contracts, and he was good at what he did. So he kept getting more contracts. And he decided I'm going to work on the business instead of in the business, which is, which is always good. I'm a fan of working on the business, in the business, around the business and everywhere to do with the business.
But he put together a board for himself and put together a bunch of very high paying positions, which he did some basic math, which I can only be described as on the net figures and then soon found himself in trouble. Because you can't put yourself together a board where it's costing you 1-2 million dollars just for people to eventually essentially do what you were doing by yourself yesterday. That's gonna put any pressure on any medium-sized company. And then he's just treading water is effectively using the ATO as a back so it's not paying is not paying his pay PYG he's not paying his GST is not paying his super. He comes to him, his accountant tells him to go, don't say, Josh. So it comes to see me. And we work through the issues and the potential solution for that company. And without putting exact numbers by the time he comes and sees us his videos, the ATO well over half $1,000,000.0 or 6, 7 or $800,000 in pedagogy GSD and he owes his employees maybe 70-80 grand, according to the books and records of his company and super, he says, Look, I've got aside 200 grand to settle this, can we do it with 200 grand?

We say yes, if you got 200 grand, and the company can afford to pay us the administrative costs on the way through, we think we can get the ATO across the line of Allah great to take 200 grand. Now, keep in mind that those sorts of deals are only generally available in an administration type process, you're not going to be able to get your accountant to talk to the ATO and get him to take off had actual debt. your accountant, generally speaking, will be able to get rid of penalties, interest, all that sort of stuff. But if you've lodged passes, which say you've got tax that you've got to pay and hold on behalf of your employees, the ATO is not going to forget about that in the ordinary course of business. But through the voluntary administration process, they're

going to take a more high-level view as to what's better for the country. What's better, this country putting what's better for those employees, and I'll have a look at it. Okay. So we go all guns blazing, the administrators myself appointed, and we continue to trade the company on as we put together a report for the ATO to essentially take this money. During this time, we go through the employee super narrowed a lot more than that original sort of 50 to 70 grand that we thought was owed. And by the time we issue our report to the ATO, it's it's already up closer to 100 grand

Joanna: For the employees in relation to the super keeping in mind that the employees and employee entitlements when they're owed money, they get paid before the general body of creditors, which includes the ATO for GST, we issue the report, we're still on board, we still think it's better for the ATO to accept these $200,000, of which $100,000 would be to pay off Super $100,000 would be gone to them today and again, is about 15 cents on the dollar at this particular point in time. Okay, but you take it away, and you've lost 20-25 really good jobs, that is 20-25 jobs supporting 20-25 families, you're raising the taxes from that you losing the mental ability and know-how these people, they're not well, besides COVID, they're not stuck in Australia in terms of their skills, they've got skills that they can go work in San Francisco, they can go pay taxes and contribute to many differences. So it's still very positive on this. But we're not sure how much is owed to Super because it's just going up and up and up. Now the process is once we issue a report to the ATO saying this is the deal. A week later, a meeting is held between my office between myself the director and all the creditors to decide whether they'll accept this deal, or the company needs to go on that during that week. We keep chipping away at the outstanding super working through more documents, even more employees finding out what we can find speaking to more people in the ATO super team, which is different to their effectively their liquidation administration deals team so to speak. And by the time the meeting is held, the amount of super that's owed is now a quarter-million-dollar. So we now are offering the ATO less money than what's out in Super. So they're going to get nothing, they're debt, 7-800,000 dollars completely wiped the super even the employees, they're gonna be ripped off 50 grand employees, we have a meeting with the employees beforehand to tell them this, please want to go because keep in mind, although 50 grand sounds like a lot when you diluted amongst that many employees, you keep in mind, this is their job. We've got to go find a new job and go through that process,

Joanna: The importance is that you had to essentially get all of these people to agree that it's better for the company to stay alive and to continue trading on the basis that you've come to this deal in relation to a reduced payout to each of you know into that ATO into each of the employees. And so this is part of your work in trying to keep the doors open so that the business postless can trade on.

Joshua: Correct because for businesses such as this one, they do have a bright future, they just they've just been compromised by mistakes in the past. And if you can package that compromise to get there in a financial arrangement, which meets with the Corporations Act and meets with what everybody's willing to accept, then there's no reason to keep going. Obviously, it'd be better if everybody paid for everything all the time,

Joanna: You're saying that in this instance, they couldn't so sort of the decision is closed the doors, employees lose their job, the funds are liquidated and the assets in the business and liquidated and everyone takes what they can or we come to this

compromise and allow the business to keep trading and hopefully after that, you know being on a positive footing, and then from there on fourth be able to pay their taxes and their employees along the way. And so what happened here in this instance, Did everyone end up agreeing?

Joshua: And so in this instance, the short answer is everybody didn't end up agreeing. The reason they do end up agreeing or they ended up agreeing in this one is the creditors in the ATO looked at a few things one what they'll get into liquidation. If the doors are shut, what happens then? Okay, and this is the only sort of formal process or time that has happens, oftentimes people will threaten if you don't take your car, put it into liquidation. That's usually people don't respond too well to that type of negotiation. This isn't done in a threatening way, this is just done in a formal process, you've got two doors to open either this one or that one because it is the creditors choice. It's their choice. So if you open this one, or got in this direction, and the second one is, is we point out, and that's at least part of what I say is our role, the intangible factors to the agio, because the ATO, unlike other institutional creditors, will say care about the return to the ATO. They have a big, big care factor on what the right thing to do, by the Australian people the country is. And so they might just take into account the cents in the dollar return. Whereas certain institutions, might require 10 cents 20 cents of lap 270 8092, full repayment of the debt before they'll agree to anything. The ATO takes them all sort of holistic, everything approach to the decisions they made. So the endgame result of that is this guy instead of living day to day, week to week with a company, burdened by getting close to a million dollars worth of debt, and superannuation, which, whether he knew it or didn't know, it was a quarter of a million dollars to $200,000, he's paid his employees super. One would like to hope that, you know, it all works out moving forward. And he's also just completely wiped out at a debt. Now, I wouldn't suggest that sort of circumstance. As you're moving forward, because you need a better you need a better offer. Generally, it's just, it happened naturally like that. And so you're so you can get to the result sometimes, but that result was obviously much better than what we anticipated at the start.

Joanna: Yeah. And of course, the race for the director had, he didn't have pulled the cord and gone and sought proper advice at the time he did was exposure to personal liability as well.

Joshua: So yeah, so personal liability in these sorts of situations is twofold when you get a DPN issued against you now, most rational people will go and say that

Joanna: that's Direct Penalty Notice for DPN for those listeners who don't know that, that acronym DPN. Sorry, keep going.

Joshua: Yeah, so when someone gets a notice like that, you should definitely call your accountant or your solicitor, surely, Joanna will be happy to take people through the process when that happened. And the other way is if you don't mind your tax returns within three months of their due date. So if your passes are outside three months in the due date, you can get locked down to personal liability, without even a DPN. So even if you can't pay for your passes make sure you lodge them. The agio brought that in because they're sick of people not lodging, or, or using that as an excuse. What people would often do is they'd come in and see an accountant with five years of lodgements not done because they're behind. And they didn't want to do them and get a DPN against their name. The Dart is a penalty notice. So their accountant would send

them on to the liquidator and the liquidator will liquidate the company and the director, in all likelihood, might have avoided personal liability because the ATO never got a check. Whereas this way, they've got a way of automatically getting it. So always keep in touch with your accounts and your lawyers. And look at most accounts these days, they offer the sort of fixed price and sort of monthly service arrangements, which I'd encourage people to use. And I say that I'm not a general practice account, but I don't I don't like even maybe there I have a general practice account. And I don't like the arrangements where you're concerned to speak with someone because of the cost. Whereas there are good lawyers out there like Joanna who will always take your call without charging you but accountants people are a bit more nervous about them because they are a bit more rule-based. And so you can make sure you get yourself in a good arrangement there.

Joanna: I think the other thing, though, to mention and be super clear about is is the risk also for directors in insolvent trading

Joshua: Yes, the risk. So there's a couple of risks the first risk that everybody talks about is insolvent trading. And that's because it's probably the easiest case for a liquidator to make against a director. So it's the largest risk. There are also other risks like directors duties, sort of and why you might see that is where you see people sort of rip stuff out of companies and enter into transactions that a director shouldn't be entering into. There's also specific sections of the Corporations Act that that attack those transactions as well. So It's not just a general thing, it's you can specifically show something in particular and personal guarantees. So people have signed personal guarantees, be aware of that. If your company goes into liquidation in all likelihood, the creditor has a personal guarantee it's going to go after you personally. And that links in with director penalty notices and a to lockdown DPN. So, if you owe the ATO million dollars, you're much better off on the $80 million, which they can't get to you personally. Okay, because then it can just go with the company. Pending that you don't have any insolvent trading thought with someone trading to spend a bit more time on that. It's where you've kept incurring debts where a reasonable person knew that you were insolvent. Okay, so if you keep incurring debts at a time when you're insolvent now there's there'll be a lot of argument about when and when you will not insolvent and there are a few defences. Nowadays, there's a Coronavirus defence for last year, which kept you out of insolvent trading. Basically, if you're going down because of the Coronavirus, when we get done. There's now the Safe Harbor defence. So if you spoke to a solicitor, and again, you can definitely get Joanna a call, and she walks you through all of that to help you get a strategy to try and turn this around, then you can invoke what's called the Safe Harbor type defence. So where is the court Look, I took steps to try and make things better for me trading wasn't making it worse, I was trying to make it better. It's just the business had gone that bad, or the market was that bad, that kept going negative. And here we are.

Joanna: I think the takeaway of all of this is, you know, if your organization is suffering, really, you know, difficulties in you being able to pay debts when they fall due that that's really the test. If you're suffering a cash crunch, you really need to seek advice early. And you know, get serious about it. Because there are a number of things that can be established along the way where you've had the right advice along the way. But organizations, you know, I just always have this memory of when I was a junior solicitor, we had a client come into the firm that I was practising at the time. And he just had this horrific story of this really fast, a gross business he'd done, you know,

really well was related to the construction industry, where you had a client, that a really big client that just stops paying. And you know, and this can happen certainly can happen very regularly in the building construction industry, but it can happen in an industry where you're exposed, we particularly exposed to a small number of clients that could create a cash crunch if they stopped paying for some reason. And ultimately, what happened, in the end, was it just because he was so exposed and left it so late to get advice, there was nothing that could be done at the time. And he ended up in a discussion with his accountant and, and liquidate the business ended up going down. He ended up in personal bankruptcy because of all of the personal guarantees that he'd signed, because he comes to this to like his marriage ended up in tatters. And, you know, he came into the office one day and was just talking to me and, you know, and he was in tears because his entire his business had imploded and been this, you know, this on this massively huge growth trajectory, but then it completely imploded. And he, you know, his employees would just, you know, they'd been left out of pocket and he just felt horrific for them. He had suppliers chasing him, he had death threats, actually, his marriage ended up in tatters, and he was a broken man. And I just thought at that point, this stuff is so important. It's so important to get in there early. And we're not suggesting that any of our listeners are likely to end up in a situation that dire but the reality is, it can happen and you just need to be aware of the signals get in early and get the right advice. I think that's the takeaway. And that's something I think this is a really great example you've given us of someone that was facing a dire situation in their business, but getting the right advice at the right time, meant that they were able to turn it around, come to a full stop and then start again and hopefully when they started again, they learnt the lessons of whatever it was that you know cause them to be in that situation in the first place. And were able to run them in a different way, but you know, it's a terrible outcome when issues in the business, pull everything down with it, you know, and I guess that's what we all, you know, we really all want to avoid, because that there are no winners in that situation none at all.

Joshua: Yeah, and I think, also encourage your brands, who are like the keys if you're failing to fail fast, yeah. And everybody sort of reads into things, what they want to read into them. But for me, you can go through a long drawn out problem, but you can get on top of your problem, either lose it or win it, solve it or not solve it, but deal with it quickly. And then get on to whatever else that is you want to achieve or you think you can achieve with your skill set with your personal business or company moving forward. The other takeaway, I think that besides getting on top of it early it's important who you involve, because the realities in Australia is that liquidations and administrations can be a very harsh and punitive process, they can also be very restorative and helpful process. And the same could be said with sort of using solicitors and litigation. They can work really well, you can get really good results, or it can just be an absolute nightmare for everyone. And, and the key thing I think, and I see and I work with a lot of solicitors, and the first thing you gatekeeper is your solicitor, and you've got to go with someone who is interested with long term arrangement, they're not just interested in a big fee or one big job and they care about you in the business for the long term and pick up on what you've got says about that, because then they will inevitably work with insolvency people who are like-minded because insolvency ultimately, we have a lot of relationships with a lot of different people. And there are all sorts of different types of administrators and liquidators out there just like there are all sorts of different types of solicitors out there. So when you choose your solicitor you speak to oftentimes the solicitor will generally match up with the sort of insolvency practitioner that you go with. And you might not need to be liquidated, you might need

to be liquidated, you might need to go into administration, you might not but all those processes can end up with you running a much more successful business on the other side, depending on how you go about it and the people you have involved.

Joanna: So don't stick your head in the sand, attack it head-on, I think that's what we are saying.

Joshua: Yeah, so getting there early and getting there with the right person that is in there for you and your business as opposed to just sort of the first person that you see you're someone that your gut tells you this person is the right person.

Joanna: I love it. Well, that's been a really good discussion today, Josh, I'm very heavy topics. But I am just like, I just think this is such an important message for business owners to hear because you know, a business can be hard times can change. It's super important to be aware that in periods when you think you're most protected, you might actually be your most vulnerable. So say for example, in those examples, we talked about a fast growth just to keep your finger on the pulse but absolutely to get help early rather than like not put your head in the sand. Josh, how is it that our listeners can find you if they want to talk to one of the good guys who have liquidations and administrations and of course, we have many accountants who are listening to our show as well. So how can they contact you if they'd like to

Joshua: Feel free to call either my mobile on 0402737647 or the work phone is 0284883126 that's a Sydney number. We've got an office at 175 Lower Gibbes St, Roseville NSW 2069. My email address is jtaylor@taylorinsolvency.com.au and obviously our website taylorinsolvency.com.au.

Joanna: Cool, and we'll link straight through to Taylor Insolvency website on our website and in our show notes as well. Just want to say a huge thank you, Josh, for coming onto the show today. It's been really good to have you.

Joshua: No worries Thanks for having me, Jo.