REPORT 670

Response to submissions on CP 326 Chapter 6 relief for share transfers using s444GA of the Corporations Act

October 2020

About this report

This report highlights the key issues that arose out of the submissions received on Consultation Paper 326 *Response to submissions on CP 326 Chapter 6 relief for share transfers using s444GA of the Corporations Act* (CP 326) and details our responses to those issues.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

This report does not contain ASIC policy. Please see:

- Regulatory Guide 6 *Takeovers: Exceptions to the general prohibition* (RG 6);
- Regulatory Guide 111 *Content of expert reports* (RG 111); and
- Regulatory Guide 112 *Independence of experts* (RG 112).

Contents

A Overview

1 Section 444GA of the *Corporations Act 2001* (Corporations Act) allows shares of a company in administration to be transferred by an administrator as part of a deed of company arrangement.

2 In Consultation Paper 326 *Chapter 6 relief for share transfers using s444GA of the Corporations Act* (CP 326), we consulted on proposals:

(a) to include guidance in Regulatory Guide 6 *Takeovers: Exceptions to the general prohibition* (RG 6) about when we will grant relief to facilitate a s444GA transfer, namely where:

(i) an independent expert report (IER) is prepared in accordance with Regulatory Guide 111 *Content of expert reports* (RG 111); and

(ii) the IER and explanatory materials are made available to shareholders before the s444GA hearing;

(b) that the IER should be prepared solely on a liquidation basis where the only alternative is liquidation. Where the valuation shows no residual shareholder equity on this basis, we will normally grant relief, subject to the IER and explanatory materials being provided to shareholders and the court granting leave; and

(c) that the IER should be prepared consistent with the principles in Regulatory Guide 112 *Independence of experts* (RG 112). In our view, this would preclude the administrator (or another member of the administrator's firm or party associated with their firm) being the independent expert.

3 This report highlights the key issues that arose out of the submissions received on CP 326 and our responses to those issues.

4 This report is not meant to be a comprehensive summary of all responses received. It is also not meant to be a detailed report on every question from CP 326. We have limited this report to the key issues.

5 We received one confidential and 14 non-confidential responses to CP 326 from a range of stakeholders, including professional bodies, law firms, professional services firms, experts and administrators. We are grateful to respondents for taking the time to send us their comments.

6 For a list of the non-confidential respondents to CP 326, see the appendix. Copies of these submissions are currently on the CP 326 page on the ASIC website.

Response to consultation

7 Respondents were generally supportive of our proposals to provide clarity about when we will give relief from s606 in the context of s444GA transactions.

8 At a high level, we noted that:

(a) submissions from administrators, law firms and related industry associations generally, although not unanimously, advocated that ASIC should not require an IER because IERs are costly and take time to be produced, potentially prolonging the s444GA process. However, if ASIC is to require an expert's report, they submitted that:

(i) a going concern valuation was not necessary; and

(ii) administrators (or others in their firms) are sufficiently independent and should be allowed to author them; and

(b) submissions from independent experts, some administrators and a shareholder advocacy group advocated that ASIC should require IERs, with a minority submitting that they should be valued on a going concern basis. They did not consider administrators could be considered independent for these purposes.

B Requirement for an IER

Key points

This section outlines the feedback we received on our proposal in CP 326 to require an IER, including feedback on whether:

- we should require an IER to be prepared in accordance with RG 111, and whether the IER and the explanatory materials should be provided to shareholders before the hearing;
- there are situations where an IER might be unnecessary; and
- the administrator's report to creditors could be used instead of an IER.

Requirement for an IER prepared in accordance with RG 111

9 In CP 326, we proposed to require an IER to be prepared in accordance with RG 111, and that the IER and the explanatory materials should be provided to shareholders before the hearing.

10 We asked stakeholders whether an IER was necessary and in what circumstances and whether the administrator's report to creditors prepared under Rule 75-225(3) of the Insolvency Practice Rules (Corporations) 2016 could be used instead of an IER.

Stakeholder feedback

11 The majority of respondents submitted that an IER prepared in accordance with RG 111 should be required and that the explanatory materials should be provided to shareholders before the hearing. Many respondents also submitted that the administrator's report to creditors was not appropriate to be used instead of an IER, citing concerns such as:

(a) the administrator's report to creditors is for a different purpose and audience; and

(b) shareholders need an independent and objective analysis when considering whether they should object.

12 Respondents against the requirement for an IER generally submitted that:

(a) the cost of an IER was ultimately borne by creditors;

(b) the time needed to prepare an IER prolonged the s444GA process unnecessarily;

(c) the courts routinely accepted valuation evidence of administrators; and

(d) the administrator's report could be tailored to include additional information/analysis to suit the information needs of shareholders.

13 A number of respondents who were in favour of IERs being provided acknowledged that there may be cases where it was overwhelmingly clear there could be no possibility of a return to shareholders and therefore little value in commissioning an IER.

14 One respondent submitted that an IER was only appropriate for solvent takeover transactions where the magnitude of the valuation is critically important; whereas in a s444GA transaction, all the information that a shareholder needs to know is that the value of equity is below zero, which is adequately covered by an administrator's report.

ASIC's response

Consistent with the reasoning in CP 326 and our updated guidance in RG 6, we will continue to generally require that an IER consistent with the guidance in RG 111 is prepared. This will form part of the explanatory materials that are sent to shareholders before the court hearing and is a condition of us granting relief from Ch 6.

In addition to new guidance in RG 6 describing the circumstances where ASIC will grant relief, we have provided guidance in RG 111 on the content of expert reports compiled for a s444GA transaction. RG 111 now provides that:

- the expert should conclude whether there is any residual equity value for shareholders;
- there is no requirement for a 'fairness' and 'reasonableness' opinion;
- there may be exceptional circumstances where an expert's report is not required, for example where the company is in administration, has no business and holds assets of negligible value; and
- a going concern valuation is not generally required (see Section C for further detail).

C Valuation basis for IERs

Key points

This section outlines the feedback we received on our proposal in CP 326 to require that an IER should be prepared solely on a liquidation basis where the only alternative is liquidation, including feedback on whether:

- ASIC should require an IER to only be prepared on a liquidation basis;
- an independent expert should consider potential recoveries from voidable transactions and other matters as a result of the administrator's investigations;
- a going concern valuation is relevant or useful for a company in administration;
- ASIC should refuse relief where the going concern value shows the shares have some value; and
- there are any other factors that ASIC should take into account when considering whether to grant relief.

Valuation basis for IERs in a s444GA transaction

15 In CP 326, we proposed to require an IER to be prepared solely on a liquidation basis where the only realistic alternative is liquidation. We also proposed that where the valuation shows no likely return for shareholders on this basis, we will normally grant relief, subject to the IER and explanatory materials being provided to shareholders and the court granting leave.

Stakeholder feedback

16 The vast majority of respondents agreed that the IER (if required) should be prepared on a liquidation basis only.

17 A respondent submitted that, in addition to the liquidation basis, there should also be a requirement to assess the business using a 'distressed valuation' basis. In the respondent's view, liquidation value is generally considered to be a 'break up' value, but in circumstances where a business is likely to be sold as a whole, on an orderly but distressed basis, then it is appropriate to value the business as a whole.

18 The majority of respondents agreed that potential recoveries from voidable transactions and other matters as a result of the administrator's investigations should be included when an independent expert performs a liquidation valuation. Some respondents thought there may be practical difficulties for

an independent expert when considering potential recoveries for voidable transactions, including that:

(a) it may be difficult to establish 'reasonable grounds' for their inclusion in an expert's report;

(b) experts will need to rely on the expertise of the administrator; and

(c) they are unlikely to be material.

ASIC's response

Consistent with the reasoning in CP 326, RG 111 now provides guidance that an expert's report prepared for s444GA does not require a going concern valuation of the company in administration.

We expect that it will be clear from the administration process whether there is a business capable of sale, or a series of assets that should be valued on a piecemeal basis.

Where a company under administration holds assets that form a business, the expert should generally base the assessment on the higher of:

- the sum of liquidation value of the underlying business assets; and
- the value of the business as a whole.

Valuations of residual company assets should generally be determined using the premise of 'an orderly transaction with a typical marketing period'. The marketing period assumption should be disclosed by the expert.

A business will likely be subject to various constraints associated with the company being under administration. These may affect the expected performance of the business directly and/or perceptions of business risk to potential acquirers. These should be considered by the expert in deriving the expected sale value of the business and disclosed in the report.

We have also provided further guidance on the form and content of expert reports for s444GA transactions, including the need to consider valuation evidence provided by the sales process conducted by the administrator as well as the value (if any) of any potential recoveries for voidable transactions.

D Who should prepare the IER?

Key points

This section outlines the feedback we received on our proposal in CP 326 to require an IER to be prepared consistent with the principles in RG 112. We asked whether:

- stakeholders agreed with our view;
- the concepts of independence should be based on RG 112 or, if not, what other standards should be applied; and
- another member of the administrator's firm (or their advisory/consulting arm), who has not been involved in the administration, should be allowed to prepare an IER.

Who should prepare the IER for a s444GA transaction?

19 In CP 326, we proposed to require an IER to be prepared in accordance with RG 112. In our view, this would preclude the administrator (or another member of the administrator's firm or party associated with their firm) being the independent expert.

Stakeholder feedback

20 The majority of respondents submitted that the concepts of independence in RG 112 were the appropriate standards to apply for an IER in a s444GA transaction. For reasons similar to those set out in CP 326, these respondents submitted that administrators could not comply with them.

21 These same respondents also agreed that another member of the administrator's firm or party associated with the administrator's firm (or their advisory/consulting arm) should not be allowed to prepare an IER.

22 The five respondents who disagreed with ASIC's position advanced the following reasons:

(a) the administrator's independence is not compromised as a result of needing to undertake steps (including by preparing an IER) to implement a s444GA control transaction approved by creditors. Shareholders should take comfort from the fact that they are owed duties by the administrators in their capacity as fiduciaries and officeholders;

(b) administrators are subject to independence requirements in the Corporations Act and by the Australian Restructuring Insolvency and Turnaround Association (ARITA);

(c) courts have accepted that administrators can give evidence on solvency and valuation; and

(d) RG 112 is not a relevant measure of independence in the case of preparing an IER for a s444GA transaction.

ASIC's response

As outlined in CP 326 and our updated guidance in RG 6, our concerns are not related to the competence of the administrator or any perceived bias towards creditors, as the courts have held that administrators owe their duties to the company, rather than to creditors or shareholders directly. Our main regulatory issue is with the appearance of independence.

We appreciate that administrators or other insolvency professionals must comply with their statutory and common law duties (and the guidance and professional standards of bodies to which they are a member). However, when considering independence in the context of:

- an application for relief from the takeover provisions; and
- information for shareholders about a transfer of shares,

our view (which we have included in RG 6) is that, given the nature of the work, an administrator (or someone else in their firm or associated with their firm) should not prepare 'independent expert' reports as they cannot comply with the RG 112 concepts of independence.

Appendix: List of non-confidential respondents

- Arnold Bloch Liebler
- Australian Restructuring Insolvency and Turnaround Association (ARITA)
- Australian Shareholders Association
- Baker McKenzie and KordaMentha
- BDO Australia Ltd
- Condon Associates
- Hamilton Locke
- Herbert Smith Freehills LLP
- Institute of Chartered Accountants Australia and New Zealand (CAANZ)
- KPMG
- Law Council of Australia
- Leadenhall Valuation Services Pty Ltd
- Minter Ellison
- Ticcidew Pty Ltd