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Terence Kouts
Australian Securities & Investments Commission
Level 5, 100 Market St
Sydney NSW 2000

27 February 2020

Dear Sir

BDO SUBMISSION TO ASIC CONSULTATION PAPER 326

BDO welcomes the opportunity to provide input to the consultation on Chapter 6 relief for share transfers using s444GA of the Corporations Act and its relevance to the independent expert report regime.

BDO Corporate Finance has been the leading advisor for independent expert reports in Australia for over 12 years and we prepare reports of a high standard to protect and support shareholders in their decision making.

Our experience covers a variety of transactions including acquisitions and disposals of significant assets, corporate restructures, share buy-backs, takeovers, general merger and acquisition activity, and s444GA applications. The preparation of these valuations requires not only technical valuation skills but also an astute commercial awareness and an in-depth understanding of the relevant industry. This is even more so when the report is being prepared for listed companies and we, therefore, take our position as industry leaders very seriously.

BDO welcomes guidance from ASIC on s444GA applications as it will provide clarity on the expected requirements of both ASIC and the Court and is an opportunity to continue working towards maintaining a high standard in expert reports. It is with this in mind that we provide below our submissions to the consultation paper and the specific questions posed.

Yours sincerely

[redacted]

Sherif Andrawes
On behalf of BDO

Maintaining Independent Expert Report Standards

Australian law, supported by RGs 111, 112 and where relevant industry codes or standards such as APES 225, VALMIN, and JORC, offer shareholders a protective framework against unfair prejudice and treatment.

IERs, properly prepared under the guidance and codes, are an integral part of this protective framework. They are independent assessments, reasonably based, and explain to shareholders how a conclusion was reached. Shareholders are then able to rely on this information to make decisions on their investment. It is for this reason that BDO supports the work being done by ASIC to ensure IERs remain at a high standard and we do not support general exceptions to this standard.

A s444GA application affords shareholders the right to avail themselves of an opportunity to object to the expropriation of their shares, and an IER, prepared under current expert report requirements, provides them with the independent information they require to make their decision. To not require an IER be provided to shareholders or, to grant a general exception from the requirements that govern the preparation of IERs for s 444GA applications would remove shareholders from this protective framework.

BDO understands that there may be case by case circumstances where an exception to certain requirements of the regulatory guides, standards, and codes may be reasonable, however, we do not agree that an application under s444GA of itself is sufficient to provide a general exception.

More particularly this is because any general exception would:

1. Likely result in shareholders not receiving the information they require to make an informed decision. An administrator's report is prepared for creditors who have different interests than shareholders;
2. Undermine the quality of any information shareholders do receive as experts will not be required to meet the requirements of the regulatory guides, APES standards, and industry codes;
3. Potentially allow such IERs to be prepared without an Australian Financial Services Licence depriving users of the IER from the confidence and protection that comes with an AFSL; and
4. Undermine shareholder expectations that an administrator’s report is an independent opinion and will be misled over the true value of a s444GA expert opinion for them (RG112.5). Based on our understanding of RG 111.106, 107 and 110 we do not believe that including prominent disclaimers on a lack of independence or ability of shareholders to rely on a report is a plausible solution.

An application for Chapter 6 relief to ASIC, allows ASIC to apply specific exceptions should the circumstances of a particular application warrant it. This current approach protects shareholders and maintains expert report standards.

The 'Cost' Argument

BDO is of the view that the cost of providing information to shareholders, particularly retail shareholders, is a cost of doing business as a disclosing entity and is not sufficient, in most circumstances, to justify a general exception to the well-accepted IER regime.

The cost of an IER, prepared under the requirements of RGs 111, 112, APES 225, JORC and VALMIN, is generally a small component of overall transaction costs, particularly when compared to the level of administrator fees.

Expert fees do increase with the complexity of the valuation however, this is when an independent assessment, reasonably based and explained, is most required. It would be counterintuitive not to provide a properly prepared independent report because of the complexity in concluding on shareholder value. We would also argue that the competition between experts for IER work is sufficient to keep a cap on report costs whereas the preparation of the report by the administrator would remove this competitive advantage currently enjoyed by shareholders and creditors.

Administrators should, however, be allowed to demonstrate that the cost of an IER will cause serious economic detriment to the entity or creditors with little or no benefit to shareholders. That is, it can be demonstrated that the burden of an independent expert report for shareholders is out of all proportion to the harm it brings to the outcome for the entity and creditors. This would be consistent with ASIC's current position on providing financial reporting relief.

BDO suggests that when applying for Chapter 6 relief an administrator should include an assessment of IER costs against all other transaction costs, including administrator fees. In BDO's experience it would be unlikely that IER costs would be overly onerous and cause sufficient detriment to justify not providing the information to shareholders.

The 'Previous Shareholder Applications' Argument

We also do not agree that the value of information for shareholders should be measured against the success of past shareholder objections as these objections are unrelated and possibly made by unsophisticated shareholders without the financial capacity to cover the costs of expert advice.

This argument also undermines the current statutory and listing rule requirements for IERs in other control transactions where unrelated shareholders, individually or together, may not form a majority.

The 'Considerably Less than the Liabilities' Argument

An administrator's report, prepared for creditors, may conclude that the value of the business is considerably less than the liabilities however is generally not sufficiently detailed, on its own, to conclude whether the entity's assets may have a current or future value on a going concern basis. Without an independent expert report, including an 'if not, why not' going concern conclusion (see BDO submissions on B2Q1 and Q4), the Court may not be in a position to balance creditor value against shareholder prejudice.

Additionally, shareholders and the Court may not have confidence that a report prepared by an administrator is independent (including perceived independence) and is prepared with the interests of any party other than creditors in mind.

The 'Requirements of the Court' Argument

The Court deliberates on whether shareholders would be unfairly prejudiced by granting the s444GA application. In relying on the evidence put before it, the Court is likely to expect that the evidence was from an expert, relevant to the position of shareholders, reasonably based, not conflicted and that the valuation methodologies relied upon are appropriate and reasonable.

RGs 111, 112, APES 225, and where relevant JORC and VALMIN, set these standards for expert reports and therefore provide for the Court's expectations. A general exception to these standards is likely to result, in the absence of careful ASIC review, in variations to the quality of the information provided to the Court.

It is with these views that we submit the following responses to ASICs questions.

PROPOSAL B1

We propose to include guidance in RG 6 about when we will grant relief to facilitate a s444GA transfer, namely where:

(a) an IER is prepared in accordance with RG 111; and

(b) the IER and explanatory materials are made available to shareholders before the s444GA hearing.

B1Q1 *Do you agree that ASIC should require an IER to be prepared in accordance with RG 111 and that the IER and explanatory materials should be provided to shareholders before the hearing? If not, why not?*

BDO: To maintain the current expert report standards and protect shareholders as argued above, BDO agrees with Proposal B1Q1 to the extent that the IER should comply with the relevant paragraphs of RG 111 and the 'if not why not' valuation approach recommended under our submission to Proposal B2 below.

B1Q2 *Are there situations where you consider the IER might be unnecessary? If so, please outline the circumstances.*

BDO: Based on our arguments above BDO does not agree that there are circumstances whereby shareholders, particularly retail shareholders, should not receive an independent report setting out the assumptions and conclusion on remaining share value.

An independent expert report arms shareholders with the information they require to make an informed decision on whether to avail themselves of the opportunity to object to the expropriation of their shares.

B1Q3 *Do you consider that the administrator's report to creditors could be used instead of an IER? If so, on what basis? If not, why not?*

BDO: As set out in CP 326, an administrator's report, under current practice and requirements, is prepared for creditors, not shareholders. It provides an opinion on the administrator's view of best interest for creditors and these creditors are often sophisticated investors with the capacity to conduct their verifying analysis.

BDO is of the view that the use of an administrators report providing shareholders, particularly retail shareholders, with the information they require would depend upon whether:

1. The report is required to include an expert valuation prepared under the relevant paragraphs of RG111- adjusted for an 'if not why not' approach posed under B2 below, and

2. The administrator is:
    a) Independent – as required under RG 112 and the existing expert report regime
    b) Competent and appropriately licensed to provide general financial product advice on the value of an entity's securities – RG 112.11
    c) Sufficiently experienced to review a technical specialist report,
    d) Able to mitigate against bias through self-review, and
    e) Prepared to provide the report to shareholders without disclaiming liability.

PROPOSAL B2

If we proceed with Proposal B1, we propose that the IER should be prepared solely on a liquidation basis where the only alternative is liquidation. 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.

B2Q1 *Do you agree with our proposal that an IER should only be prepared on a liquidation basis? If not, why not?*

BDO: BDO agrees that there are circumstances that warrant the preparation of a valuation of assets on a liquidation basis only. For example when the company holds stranded or obsolete assets. However, there may be circumstances when the underlying business or assets are profitable and a going concern valuation is appropriate because there are, for example, other financing options or, additional time under a deed of company arrangement scenario is reasonable.

Rather than applying a general exception to a valuation on a going concern basis, we propose the introduction of an 'if not, why not' requirement. In this way the expert can determine the most appropriate methodology, as contemplated by RG111, and explain why the going concern valuation methodology is not appropriate in the circumstances.

B2Q2 *Should an independent expert consider, when performing a liquidation valuation, potential recoveries from voidable transactions and other matters as a result of the administrator's investigations? If not, why not?*

BDO: An expert is required to have reasonable grounds for assumptions made when preparing an IER. If there are reasonable grounds to assume potential recoveries from voidable transactions and other matters then the expert should consider such items. It is most likely that the expert will gain a sufficient level of confidence for this from legal opinions available to the administrator, or by making its own enquiries.

B2Q3 *Do you consider that a 'going concern' valuation of the business is relevant or useful for a company in administration? If so, why?*

BDO: Our submission is the same as outlined under B2Q1.

B2Q4 *If you agree with the previous question, should ASIC refuse relief where the going concern value shows the shares have some value?*

BDO: BDO believes this should be considered by ASIC and the Court on a case by case basis.

B2Q5 *Are there other factors that we should take into account when considering whether to grant relief?*

BDO: BDO suggests that in circumstances where the DOCA proponents and creditors are associated the requirement for an IER be mandatory to ensure that shareholders are not unfairly prejudiced by any conflicts of interest.

PROPOSAL B3

If we proceed with Proposal B1, we propose that the IER should be prepared consistent with the principles in 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.

B3Q1 *Do you agree with this view? If not, why not?*

BDO: BDO agrees with this view for the reasons we set out under 'Maintaining Expert Report Standards' and RG 112.5 which states:

"Security holders will assume that an expert report is an independent opinion and will be misled if the opinion is not."

An independent report would also negate the expectation that because ASIC has granted relief on the basis that an expert report is provided to shareholders that ASIC has taken a view that the report is not biased, is reasonably based, and the expert is competent.

B3Q2 *Do you agree that the concepts of independence should be based on RG 112? If not, what other standards should be applied?*

BDO: BDO agrees that the concepts of independence should be based on RG 112.

BDO supports RG 112.5 and 6 and the work being done by ASIC and experts to ensure IERs, in actuality and appearance, are independent.

To introduce alternate standards, not applied consistently across all expert reports is likely to have the effect of undermining current expert report standards, and to mislead shareholders.

BDO also supports RG 111.106 -10 and believes that the use of disclaimers will further undermine the veracity of independent expert reports.

B3Q3 *Do you believe that another member of the administrator's firm or party associated with the administrator's firm (or their advisory/consulting arm), who has not been involved in the administration, should be allowed to prepare an 'independent expert' report? If so, why? If not, why not?*

BDO: We agree that the guidance in RG112.25 setting out when an expert should seriously consider declining an engagement should be consistently applied here. It may be perceived that by acting as administrator to the company the expert's associate is conflicted by all four instances listed ie:

1. The administrator is acting in the shoes of an officer of the company;
2. The administrator is acting for creditors who have an interest in the relevant transaction;
3. The administrator has a duty to form an opinion on the DOCA that is the subject of the transaction, and
4. The administrator has acted in other than a purely compliance role.