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Reply To: Parramatta

20 February 2020

Mr Terence Kouts
Senior Manager
Corporations
Australian Securities and Investments Commission
Level 5, 100 Market St
Sydney NSW 2000

Via Email: 444GA.submissions@asic.gov.au

Dear Sir,

Re: Consultation Paper 326: Chapter 6 relief for share transfers using s444GA of the Corporations Act

We refer to your request for submissions to the Australian Law Reform Commission in relation to the proposed *"Chapter 6 relief for share transfers using s444GA of the Corporations Act"* and take pleasure in providing the following submissions.

A. CONDON ASSOCIATES

Condon Associates is a specialist Firm of Forensic, Insolvency and Turnaround Practitioners headquartered in Parramatta, NSW. The Firm undertakes Liquidations (Official and Voluntary), Receiverships, Voluntary Administrations and Deeds of Company Arrangement under the provisions of the Corporations Act 2001 (Corporations Act), as well as the formal administration of Bankrupt Estates and Part X Arrangements pursuant to the Bankruptcy Act 1966 (Bankruptcy Act). In addition the Firm provides services within the related areas of Forensic Accounting, and Litigation Support as well as business and financial Turnaround and Advisory Services not involving formal appointments.

It should be noted that the general focus of our corporate work is in the small to medium, proprietary companies rather than Publicly Listed entities.

The Firm's Managing Principal, Schon Gregory Condon, was an Official Liquidator, and continues as a Registered Liquidator and Registered Trustee in Bankruptcy with in excess of 40 years of experience in the business recovery/insolvency field, with almost 30 years plus at the Principal/Partner/Director level.

B. OVERVIEW

1. Preamble

We consider that it is important to consider the historical context of what it is to be a shareholder of a company at this point.

CONDON ASSOCIATES
FORENSIC INSOLVENCY TURNAROUND
Head Office
Level 6, 87 Marsden Street, Parramatta NSW 2150
T 02 9893 9499 | F 02 9891 1833
P PO Box 1418, Parramatta NSW 2124
E enquiries@condon.com.au
NSW Offices
Sydney
Central Coast
Penrith
Bankstown
Central West
National Offices: AUCKLAND ADELAIDE BRISBANE CANBERRA MELBOURNE PERTH

The modern notion of an incorporated company was introduced in the United Kingdom by an act known as the Joint Stock Companies Act 1844. Prior to the Act it was only possible to incorporate by Royal Charter or a private Act of Parliament. The Act made it clear that the shareholders of the company were liable for the debts of the company in the same manner as they would be in a partnership.

Subsequently in 1855 the Limited Liability Act was passed, this then limited the shareholders liability to the amount of shares they held. Both the 1844 Act and 1855 Act were consolidated into the Companies Act of 1862 and it is this legislation that was introduced into NSW and Victoria, noting that this occurred prior to Federation.[1]

The fundamental point of the above is that it was always intended that Shareholders rank behind Creditors and that no return should be expected until such time as all Creditors are paid in full regardless of the size or nature of the entities.

2. Scenarios

In order to properly consider the issue raised by Australian Securities and Investments Commission (ASIC) we have built our response around two different scenarios, one that deals with smaller businesses with limited shareholding, commonly dealt with by all practitioners, and one that deals with larger entities with a larger group of shareholders who are commonly unrelated. These are more fully explained throughout our response.

3. General

In order to consider the scenarios, we have made a number of baseline presumptions, these being that the Company is currently the Subject of an External Administration process specifically that the company is in Voluntary Administration. Secondly, there is a party that has put forward a proposal. That the proposal requires the future Deed Administrator to deal with the shareholders. It will be taken as a given that the Creditors of the company will pass the resolution accepting said proposal in respect to both what is owing to them as well as the proposed return.

We do not believe it is necessary to go into the specifics of the proposal suffice to say that it will impact the shareholding of the company. However its acceptance will maximise the value of the return for the Creditors in general and, in particular, either a greater or even the then existence of a return to ordinary Unsecured Creditors.

In essence we are considering the need for a further party to be involved in the Voluntary Administration process to provide an Independent Experts Report (IER).

C. SCENARIO ONE

Under '*Scenario 1*' we are looking at small companies such as family businesses or what could effectively be described as a partnership operating using a corporate structure. These essentially only have 1 or 2 shareholders which are generally closely related or associated.

[1] "The Historical Development of Corporations Law" - Francis Forbes Society for Australian legal history introduction to Australian legal history tutorials the Hon T F Bathurst, Chief Justice of New South Wales, Sydney, 3rd September 2013.

It is apparent based on the facts of the case that there is likely to be no return to the ordinary Unsecured Creditors unless some proposal can be propounded. This is due to the nature of the assets being held. They are generally minimal and commonly consist mainly of non-physical assets such as intellectual property, rights to certain items, titles, carried over losses, contracts, licences, rights, etc.

A proposal is received that would see the company's Creditors receive something of what is owed as opposed to nothing. This proposal has been made by an external investor, competitor, customer or other unrelated party. The investor holds the belief that if the company is obtained as a whole and managed correctly then the company can be profitable.

The problem in such circumstances is that one or more shareholders can sometimes seek to divert funds away from Creditors for their own benefit, using the threat (normally followed by action) of the withholding of a share transfer. The ultimate effect of this is that it can lead to the collapse of the whole transaction, thus leaving Creditors with either little or no return. It can also be used as a course of action by Director/Shareholders to make their lesser proposal more workable, against a better alternative put forward by an independent party.

In this Scenario it is usually the intent that the past shareholders will have no future involvement, or if remaining their previous 100 percent holding will have now been reduced to say less than 5 percent.

We note that we have adopted the ordering and sequence of the Proposals and Questions provided.

1. ASIC Proposal B1Q1

The query being raised in in relation to the requirement of ASIC for an Independent Experts Report ("IER") prepared in accordance with RG 111. In the event of a matter such as Scenario 1, in seeking relief from ASIC, we disagree and believe that there does not need be an IER, simply that the report of the Administrators and view of current shareholders is sufficient. It is our view that the report by the Administrator would balance the proposal put forth by the External Investor and that of the Directors/Shareholders to ensure that the maximum return is gained by the Unsecured Creditors.

Primary consideration ought not to be given to the shareholders who have potentially mismanaged the Company but to the ultimate benefit to the Creditors. Whilst we note that any shareholders are likely to lose out on the return of their Capital that was the risk they chose when investing in the company initially. The alternate would have been that their investment could have been by way of loan, either secured or unsecured thus being dealt with as a Creditor.

2. ASIC Proposal B1Q2

We refer to B1Q1 above, which deals with the idea of the IER being unnecessary.

3. ASIC Proposal B1Q3

As stated above in B1Q1 above and reiterate that the Administrator is best placed to provide guidance on what they view is in the best interests for the general body of Unsecured

Creditors, as well as all other relevant parties, and then for the Unsecured Creditors to determine what to accept. As in Scenario 1 it is clear that the current state of the Company is due to the actions of the Director/Shareholders, as such those parties ought to have a limited capacity to continue with the company if there is a more viable and greater return available.

As noted above in the event of Liquidation, it is likely there will be insufficient assets to meet the claims of the Unsecured Creditors. It is the Creditor's rights to determine the fate of the Company rather than the Shareholders. The Shareholders have made a choice of investment and ought to be aware of the risks associated with the investment, which includes the potential loss of their Capital which is, in many cases, insignificant to the overall values involved.

4. ASIC Proposal B2Q1

Given our comments above, if the only alternative is a Liquidation, it follows that any report ought to be done on that basis. A company subject to Voluntary Administration has a limited number of options and if Creditors do not agree with the proposal then in reality the company will be wound up and the shareholding becomes worthless, a condition that was most likely at the time of the initial appointment. In the event of a winding up the likelihood of their being a distribution to the Members would be negligible.

5. ASIC Proposal B2Q2

In the Scenario, we do not think the IER ought to consider these issues as they would be dealt with by the Administrator in their report when comparing the alternatives. In order to facilitate a timely transfer and a return to Creditors any delays that would result in an independent expert having to undertake the same work as that already done by an Administrator would not assist the process. It follows that there will only be additional costs involved that would reduce the pool of funds ultimately available.

6. ASIC Proposal B2Q3

We would consider that the requirement to undertake a valuation on the basis of the business on a going concern basis to be of little benefit, other than in determining that the value being put to Creditors is reasonable. We hold this view as it is likely that any going concern valuation under this Scenario would be less than the value of the Creditors, and given that company has already suffered some form of failure, there will be little goodwill purely attributable to the shares that should be diverted from Creditors to the Members.

This is particular true if the circumstance the company currently finds itself in is due to the mismanagement by the Directors/Shareholders. In the Scenario the proposal is designed to change how the company is being managed so as to bring about profitability for the incoming investors, as well as see the Unsecured Creditor liabilities incurred by the previous management are met.

7. ASIC Proposal B2Q4

As we do not agree with B2Q3 it follows that we do not agree with ASIC refusing to provide relief if there is no going concern valuation.

8. ASIC Proposal B2Q5

We believe that our views above have considered all the relevant factors that need to be considered when ASIC is determining when to grant relief.

9. ASIC Proposal B3Q1

We would disagree with this view. Under this Scenario there is a limited pool of funds available and every dollar that is spent on dealing with administrative issues becomes a dollar less that is available for the Creditors to receive.

10. ASIC Proposal B3Q2

No we do not believe that the IER is required to be prepared based on the concepts contained within RG 112. The appointed Administrator is already independent of the Company on their appointment and is charged with a duty to all concerned.

We believe that the idea that the Administrator has lost their independence simply due to their appointment does not hold any substance. The role of the Administrator is to be independent, and remain independent, and assess all options available to the Company and make recommendations about what is in the best interests of all parties cognisant of their priority and rights within the law, both Statute and Common.

11. ASIC Proposal B3Q3

We refer to our comments above in Proposal B3Q2 IER ought to be the Administrator.

D. SCENARIO TWO

Under '*Scenario 2'* we are looking at a larger corporate entity with multiple, most likely unrelated shareholders, and possibly one that may be publicly listed on a relevant Stock Exchange. In these entities there are additional issues pertaining to the shareholders whose interests need to be considered, as they, as a class or otherwise, may have real or perceived claims against the Company in question.

In this Scenario it is apparent based on the facts that there is likely to be a minimal or no return to Creditors and quite possibly the ordinary Unsecured Creditors. The Scenario can also vary where there are competing secured claims, Creditor groups are being offered differing rights, and a plethora of other variations, but for clarity of this response we will simply assume that there is an overall reduction in the return to Creditors.

As indicated above, in this case the Administrator needs to take into account the not yet existing but potential claim that the shareholders may have due to potential rights to sue the Company on the basis of some perceived mismanagement, or misleading by its Board.

Again a proposal from an external party, a circumstance more common with larger entities, is received that would see an improved return to the Company's Creditors and most likely specifically its ordinary Unsecured Creditors. This proposal has been made by an external investor, competitor, customer, foreign investor, or other unrelated party. The investor

holds the belief that if the company is obtained as a whole, potentially merged with other local or foreign operations, and managed correctly then the company can be profitable.

We also note that due to the likelihood of the assets and business held in these Scenarios there is generally a significantly greater level of funds available to deal with administrative costs and procedures. The total level of Creditors in the various categories may too have an impact. It is not impossible that the claims of Unsecured Creditors may be inconsequential to the overall level of debt.

In this case the consent of the shareholders involves a much larger and independent group who are unlikely to endeavour to seek personal gain, but would rather seek reasonable compensation as a class, and thus the mechanisms need to be in place to allow the Administrator to "herd the cats" effectively and efficiently to promptly achieve a commercial resolution that benefits the majority.

We note that we have adopted the ordering and sequence of the Proposals and Questions provided.

1. ASIC Proposal B1Q1

In the event of a matter such as Scenario 2 seeking relief from ASIC, we do not believe that there needs to an additional Report prepared by an Independent Expert, as the Administrator, from their investigations, should have sufficient evidence and analysis to provide ASIC with what it requires to make a determination.

2. ASIC Proposal B1Q2

We believe that the IER would be unnecessary in circumstances where the Shareholders have already agreed to the course of action that sees an alteration being made to their shareholdings. We note that in these matters it would need to be at least an agreement by an appropriate majority of shareholders so as to ensure that each individual Shareholder is aware of what alterations are being made. They should also be aware of the impact of failing to agree to the proposal which presumably means both the failure of the proposal, and the resultant annihilation of the value of their interest, as well as the consequences of their actions on Creditors which were incurred in the pursuit of profit and a return to Shareholders.

3. ASIC Proposal B1Q3

We refer to B1Q1 above and reiterate that the Administrator should be best placed to determine what is in the best interests for Creditors. Their investigations have been, in part specifically aimed at determining this exact point. However in the event of the existence of potentially equal competing shareholder claims, e.g. a claim for damages by shareholders against the Company there may be factors that could make it prudent to obtain an IER.

It would then be for the Court to determine what specific information or analysis it requires in order to make a determination due to the peculiarities of the matter in hand and thus make a decision on the balance of the evidence as to whether to grant the ability to transfer shares.

4. ASIC Proposal B2Q1

Given our comments above, if the only alternative is a Liquidation, it follows that any Report ought to be done on that basis, i.e. no return to shareholders and thus no consideration of the issues relating thereto. A company subject to Voluntary Administration has a limited number of options and if Creditors do not agree with the proposal then in reality the company ought to be wound up, and the view of shareholders, other than in concert with a further advancement of capital, can essentially be ignored.

We note it will be difficult to prepare any report on a basis other than a Liquidation basis and in the light of the immediate circumstances, given the proposal may not specially set out how they will turn the business around and generate any future benefit for the Shareholders.

The rights of the shareholders on the appointment of the External Administrator ought to be considered to have an extremely limited value, unless there is a surplus after payment of all Creditors. This is due to the shareholders only having a right to what surplus remains after the winding up, which in most circumstances is nothing.

5. ASIC Proposal B2Q2

In the Scenario, we do not think the IER ought to consider these issues as they should have already been dealt with by the Administrator in their Report when comparing the alternatives. To concede that there are factors that the Administrator has not considered is tantamount to admitting that the Administrator has already failed in their duties. Further it would also result in greater costs for the Independent Expert and further delay their work in undertaking the requisite investigations needed to give consideration to the voidable recoveries. All at a consummate cost to Creditors.

6. ASIC Proposal B2Q3

Given that this is quite likely to be a listed entity, and there could be competing proposals, it may be prudent to obtain a valuation based on the business operating as a going concern. However any comparative valuation will need to consider what each proposal is suggesting in relation to the changes required to turn the business around, their practicality, their feasibility, the capacity of the proposer to fund and resource it and the genuineness of the intent. Such an analysis is easier said than done.

A classic example of the point being made above exists with the sale of Ansett Airlines. In that case multiple offers were made by a variety of parties, all with different benefits. The Administrator accepted one and rejected the others. Alas the winning bid, which promised everything, required Government underwriting which had not been obtained and appears not to have been considered in the analysis. Thus when that underwriting was ultimately denied the proposal/sale collapsed, with no recourse to the other offerors.

7. ASIC Proposal B2Q4

As in Scenario One above, we do not think relief should be refused based on a going concern valuation that suggests there is some value in ongoing trading. This is particularly true if the troubles of the Company are mismanagement, and the proposal is designed to change how the company is managed.

8. ASIC Proposal B2Q5

We believe that our views above have considered all the relevant factors that need to be considered when ASIC is determining when to grant relief.

9. ASIC Proposal B3Q1

We agree that in these circumstances there ought to be an Expert Report prepared, however that expert does not necessarily need to be independent of the Administrator because the Administrator will have already done significant work that would only need to be repeated a second time, at significant cost to Creditors. This of course is based on the premise that there is no genuine foundered basis questioning the independence of the Administrator in the first place; but that is a whole separate issue. Simply it could be that the Experts Report is prepared by the Administrator. If the Court subsequently determines that the Administrator has not acted in an independent manner, then that is a matter for relief as against the Administrator.

10. ASIC Proposal B3Q2

Please refer to B3Q1.

11. ASIC Proposal B3Q3

We refer to our comments above in Proposal B3Q2 IER ought to be the Administrator unless a Court has deemed them to be in conflict.

E. CONCLUSION

We congratulate ASIC on seeking wide input and thank you for the opportunity to do so. Our responses have been based on experience in the area and the available time, whilst still maintaining an active practice.

F. THE INDEPENDENT SCEPTICAL CREDITOR

In closing it may be worth considering the thoughts of a hypothetical 'sceptical creditor'. In dealing with the profession for over forty years now the responses from professional Creditors 'oft ring with a common tone'. Below is based on conversations that I have had, albeit not specifically in respect to the current questions posed by ASIC.

> *"Thank you for the opportunity to comment. The biggest desire from us as creditors is that we get our money back, or at least as much as possible, as quickly as possible. The more the laws change, the more the paper, the more the complexity and the more players that seem to drink from the same trough, ie ...ours! Our reports have grown to miniature telephone books, and none of it appears to have ever put more money back into our bank accounts. The introduction of yet another independent expert sounds like insolvency practitioners giving their mates a legitimate right to a share of Creditors money with no real benefit. I must be honest, I'm not sure that I can see the value in the intent ... at least not from my perspective as an unsecured creditor".*

Should you have any enquiries in respect of this matter, please contact the writer or Gavin King of this office on [redacted].

Yours faithfully
Condon Associates
Forensic, Insolvency and Turnaround Practitioners

[redacted]

Schon G Condon RFD
Managing Principal