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By E-mail

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Your Ref

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Dear Mr Kouts

Submission on Consultation Paper 326: Chapter 6 relief for s444GA transfers

1 Introduction

1.1 Arnold Bloch Leibler (**ABL**) is pleased to provide this submission in response to Consultation Paper 326 – *Chapter 6 relief for share transfers using s444GA of the Corporations Act* (**Consultation Paper**) released by the Australian Securities and Investments Commission (**ASIC**) on 16 January 2020.

1.2 ABL is a leader in restructuring and has been involved in some of Australia's most complex, significant and sensitive restructures in recent corporate history.

1.3 Through our experience on Oroton and other matters, we have seen how section 444GA transfers can be successfully used to salvage a business. However, while the process is intended to be an efficient mechanism to effect a recapitalisation, this has not been achieved in practice. This is, in part, due to the conditions that must be satisfied to obtain ASIC relief from Chapter 6. In our experience, there have been several circumstances where section 444GA transfers have been considered, and may have resulted in better outcomes for stakeholders, but were ultimately not pursued due to the cost and time taken to implement.

1.4 We welcome ASIC's proposal to formalise its policy in this area, particularly if the new guidance will make section 444GA transfers a more efficient and viable recapitalisation option for companies in external administration.

2 ABL response

2.1 Set out below are our responses to the questions raised in the Consultation Paper, using corresponding numbering.

B1Q1: Requirement for an independent expert's report

2.2 In circumstances where an administrator's report prepared under Rule 75-225(3) of the Insolvency Practice Rules (Corporations) 2016 shows that the expected dividend to creditors in a liquidation scenario is less than 100 cents in the dollar (or even 90 cents) a separate independent expert's report (**IER**) should not be required.

2.3 The costs of engaging an independent expert to prepare an IER are substantial, both in terms of the fees payable and also as a consequence of the delays this creates in implementing the transaction. An independent expert often cannot be briefed until the commercial terms have been agreed with the deed proponent. These costs are ultimately borne by creditors and reduce the amount available for distribution. Where there are insufficient proceeds to fully repay creditors, shareholders have no economic interest in the company. Creditors' interests should not be subordinated to shareholders in those circumstances.

2.4 We understand ASIC's concerns in relation to opportunistic creditors using a section 444GA transfer to exploit or take advantage of a short-term liquidity crisis, however, we do not think that this justifies an IER being required to obtain relief, unless the administrator's report shows that the shares have some value. In situations where, for example, the expected dividend is around 99 cents in the dollar, an IER may be appropriate.

B1Q2: Circumstances in which an IER might be unnecessary

2.5 As noted above, we think it is unnecessary for an IER to be prepared when an administrator's report illustrates that creditors will not be fully repaid.

2.6 To require a company to commission an IER and distribute materials to shareholders in this circumstance is inappropriate. All value lies with creditors, and the costs of preparing those materials will be solely borne by creditors not shareholders. Further, the IER will often repeat much of the information that has already been outlined in the administrator's report.

2.7 While we agree that shareholders should have the benefit of understanding why their shares are being expropriated without any consideration, a separate IER is not needed to achieve this and should not be required when shareholders have no economic interest. The administrator's report includes information which can help shareholders understand why their shares are being transferred (such as expected returns). Alternatively, rather than including a condition that an IER be commissioned, ASIC could require administrators to include details about any proposed section 444GA transfer in their report if ASIC is of the view that the current disclosures are insufficient.

B1Q3: using the administrator's report rather than an IER

2.8 We consider that, where an administrator's report has been prepared in compliance with Australian Restructuring Insolvency & Turnaround Association's Code of Professional Practice and guidance, and it shows that shareholders have no economic interest, it is appropriate to use this in lieu of an IER. This ensures that there is still consistency in the information being provided in these scenarios, and a minimum standard of disclosure.

2.9 While the report is prepared for the benefit of creditors, it still includes information which is relevant to shareholders and their understanding of a section 444GA transfer. As noted above, if ASIC is concerned that shareholders will not have sufficient information to oppose a section 444GA application without an IER, a condition to granting the relief could be that the administrator's report must include information about the section 444GA process if this is being considered.

2.10 We note that if there is a dispute as to the administrator's assessment of value, then this could be the subject of an application by an affected shareholder under Insolvency Practice Schedule s 90-20 (for them to seek an order varying the administrator's decision under s 90-15). An affected shareholder would need to demonstrate that it had a financial interest in the company's administration in order to bring an application, and we submit that in circumstances where there is a real question as to where value

breaks it is unlikely that shareholders would be considered to have no financial interest in the administration.

2.11 While it is market practice to require an IER in other change of control transactions, such as takeover bids and compulsory acquisitions, the key difference is that in those circumstances the companies are solvent and there is value for shareholders. In our experience, there is rarely value for shareholders where a section 444GA transaction is being pursued.

2.12 An IER should not be required for Chapter 6 relief for section 444GA transfers solely because one is typically provided for other change of control transactions, particularly when an administrator's report is already required.

B2Q1: IER prepared on a liquidation basis only

2.13 If providing an IER is a condition to ASIC granting relief, we agree that it should only be prepared on a liquidation basis.

B2Q2: IER to include potential recoveries from voidable transactions

2.14 If ASIC requires an IER to be provided, which we consider should only be in circumstances where it is unclear if shares still have value, we consider that an independent expert should have regard to potential recoveries from voidable transactions and other matters resulting from an administrator's investigations.

2.15 Including these recoveries provides a more accurate view of the amounts potentially available for distribution on a winding up. We note that an assessment of these claims is included in an administrator's report to creditors.

B2Q3: use of a 'going concern' valuation

2.16 We agree that a 'going concern' valuation of the business is unnecessary. In our experience, valuing a business on this basis has not been relevant or useful. As noted in the Consultation Paper, Courts have also generally been disinterested in this information when considering a section 444GA application.

B2Q4: ASIC relief where going concern valuation shows shares have some value

2.17 We do not agree that a going concern valuation should be required as a condition to granting relief. However, if ASIC determines that it is, we think ASIC relief should still be granted even if the valuation suggests that the shares have some value.

2.18 The administrators, as officers of a company that is, or is about to become, insolvent, have an obligation to act in the best interests of creditors. If the administrators in their report have determined that creditors would receive less than 100 cents in the dollar, a hypothetical going concern valuation from an independent expert is unlikely to show the shares have value. Such a valuation also ignores the practical circumstances and reality of the company and, as a result, has limited application.

2.19 Further, if relief from Chapter 6 is not granted, the transaction would likely still proceed, except it would by via an alternate structure that avoids Chapter 6, such as an asset sale. The end result is ultimately the same, as control of the business will have passed to the proponent, and shareholders will be left with shares in a company that has no business. Depending on the individual circumstances, this can be a more inefficient process which increases the costs borne by creditors.

B2Q5: other factors to take into account in granting relief

2.20 We think the main factor and threshold issue that ASIC should take into account when considering whether to grant Chapter 6 relief is if the shares have any value.

B3Q1: ASIC's view that administrators are precluded from being the independent expert

2.21 If ASIC relief is conditional on obtaining an IER which, in our opinion, should only be required where it is unclear if there is any value in the company for shareholders, we think it is appropriate that the administrator is not the independent expert to ensure that the expert appears to be independent.

B3Q2: concepts of independence

2.22 Again, if an IER is required for relief to be granted, we are not opposed to the concepts of independence being based on those set out in *Regulatory Guide 112 Independence of experts.*

B3Q3: allowing members of the same firm or associated firms to prepare the IER

2.23 If another member of the administrator's firm or a party associated with that firm (including any advisory / consulting arm) has not been involved in the administration, we think that they should be able to prepare the IER. To prohibit this would often create practical difficulties in being able to find someone to engage an expert, depending on who the company's other advisors are.

3 Facilitating solvent recapitalisations

3.1 We think that ASIC should also take this opportunity to provide a clear path to facilitate debt for equity restructures in a solvent context, namely through clarifying its application of Chapter 6 to creditors' schemes of arrangement.

3.2 While an exemption from Chapter 6 already exists for acquisitions of a relevant interest as a result of a scheme of arrangement, it is currently unclear whether this captures creditors' schemes, or if shareholder approval is required. ASIC's current guidelines for schemes of arrangement, and the item 17 exception, do not shed any light on this as they are limited to considering members' schemes of arrangement.[1]

3.3 In most circumstances where a creditors' scheme is proposed, there is little or no value in the company for shareholders. Some recent examples of this include Slater & Gordon, Boart Longyear and Emeco.

3.4 We understand that ASIC has previously questioned companies who have sought to rely on item 17 in connection with debt for equity swaps undertaken via creditors' schemes and have queried why shareholder approval was not sought under item 7 of section 611. In some instances, the basis for ASIC not objecting to a company's reliance on item 17 was because shareholders still had the capacity to determine whether the scheme proceeded as other elements of the scheme required shareholder approval.

3.5 In the absence of clear guidance from ASIC regarding the application of Chapter 6 to creditors' schemes of arrangement, there is a risk that reliance on item 17 may constitute unacceptable circumstances. Further, if ASIC only clarifies its application of Chapter 6 to acquisitions of relevant interests where a company is insolvent and subject to a deed of company arrangement, this risks encouraging directors to pursue insolvent

[1] See for example *Regulatory Guide 6 Takeovers: Exceptions to the general prohibition* and *Regulatory Guide 60 Schemes of arrangement.*

recapitalisation proposals rather than solvent alternatives (which may lead to an inferior outcome for shareholders, employees and other stakeholders).

ABL proposal

3.6 For the reasons set out above, we submit that ASIC should update its regulatory guidance to clearly articulate that:

(a) item 17 can be used for acquisitions of relevant interests that would otherwise breach section 606 that arise as a result of a creditors' scheme of arrangement approved under Part 5.1, even if no shareholder approval is sought in connection with implementing the scheme; and

(b) it will not require a company to obtain shareholder approval under item 7 of section 611 for any such acquisition, where:

(i) shareholders have no economic interest in the company, as confirmed by an IER; and

(ii) disclosures akin to what is required for item 7 approval are included in the scheme booklet, which is made available to shareholders,

(the **ABL Proposal**).

3.7 The ABL Proposal is consistent with ASIC's approach to, and rationale for, Chapter 6 relief for companies subject to a deed of company arrangement. As an IER is typically obtained for a proposed scheme of arrangement, unlike a section 444GA application, we also do not think this imposes an unreasonable burden on companies.

3.8 To require a company to seek shareholder approval when its value lies with creditors gives shareholders an unnecessary veto right. This is inappropriate given, in the context of a possible insolvency, all risk lies with the board. Shareholders should not be able to frustrate the board's actions in trying to salvage a company when they have no economic interest and, in a liquidation scenario, would receive nothing.

3.9 We do not consider that the ABL Proposal would diminish or prejudice shareholders' rights or interests. In a similar vein to the checks and balances that exist for a section 444GA transfer, a creditors' scheme of arrangement must be approved by the Court and ASIC also has standing to appear and object to the scheme. When determining whether a scheme should be approved, the Court must also consider whether the scheme is being propounded to avoid the protections set out in Chapter 6 as per section 411(17)(a).

3.10 We note that there are other regulatory rules and considerations that companies must navigate when proposing a creditors' scheme that can also hinder solvent reconstructions, such as the ASX Listing Rules. For example, depending on the terms of the scheme, a listed company may need to obtain a waiver from the shareholder approval requirement under Listing Rule 7.1 to issue new securities.

3.11 ASIC should be the market leader in adopting policies which facilitate solvent reconstructions and set the standard for other regulatory bodies. If ASIC provided clear guidance on its application of Chapter 6 to creditors' schemes of arrangement, other regulatory bodies may follow.

ABL welcomes the opportunity to provide further submissions and participate in further consultation in respect of the Consultation Paper and any proposed amendments to ASIC's regulatory guides.

Yours sincerely
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