Law Council
OF AUSTRALIA

Business Law Section

5 March 2020

Mr Terence Kouts
Senior Manager
Corporations
Australian Securities & Investments Commission
Level 5, 100 Market Street
SYDNEY NSW 2000

By email: 444GA.Submissions@asic.gov.au

Dear Sir,

Consultation Paper 326: Chapter 6 Relief for Share Transfers using s444GA of the Corporations Act

1. This submission is made by the Insolvency and Restructuring Committee and the Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committees**).

2. The submission is made in respect of the Australian Securities and Investments Commission's (**ASIC**) Consultation Paper 326 (**CP326**) and responds to the questions raised by ASIC therein. In this submission, the Committees respectfully adopt the usage of the "Key terms" defined on page 19 of CP326.

Summary

3. The Committees answer the questions posed by ASIC in CP326 as follows:

   (a) Valuation evidence provided by an expert other than the administrator may be necessary in some but not all circumstances. However, in those exceptional circumstances, expert evidence prepared in accordance with the Court requirements for admissible expert evidence will generally be more suitable than an IER prepared to meet the requirements of Regulatory Guide 111.

   (b) Any valuation evidence, whether from the administrator or another expert, should be made available to shareholders prior to any substantive Court hearing in respect of s444GA.

   (c) It would be very unusual for a valuation on a going concern basis to be useful.

   (d) Assessment of likely recoveries from voidable transactions will sometimes be appropriate in valuation evidence but will not usually be likely to be a material factor affecting the outcome.

(e) Often, an administrator or someone from the administrator's firm will be best-placed to prepare the valuation evidence notwithstanding their role as officers of the company.

Determining whether there is "unfair prejudice"

4. The introductory analysis in CP326 refers to the case law to date on "unfair prejudice". In any situation where the transfer of shares under s444GA is proposed, it stands to reason that a proponent would only go to the cost and effort of that transactional structure (instead of simply acquiring the requisite assets into a new entity) if ownership of the shares provides some comparative benefit. The benefit might arise in various ways. Some examples follow:

   (a) It may be expensive to transfer assets out of the existing corporate structure (for example, due to transfer fees or duty).

   (b) It may be difficult or time-consuming to transfer assets out of the existing corporate structure (for example, the asset may be one or more tenement applications that cannot be assigned until grant).

   (c) It may be impossible to transfer assets out of the existing corporate structure (for example, the asset may be a valuable licence or contract that cannot be assigned).

5. The "unfair prejudice" test and the need for court review under s444GA therefore serve as checks and balances so that the s444GA order does not facilitate a value transfer from shareholders to creditors.

Proposal B1: Whether and when an Independent Expert Report is required

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?

6. The Committees' view is that an IER should not be required by ASIC in circumstances where relief is sought, although Court-admissible expert valuation evidence may be appropriate in some circumstances.

Cost/benefit considerations

7. When considering an application for relief from s606 of the Corporations Act in order to conduct a s444GA transfer, the objects of Chapter 6 should be considered having regard to the objects of Part 5.3A of the Corporations Act, and also the objects of the insolvency provisions in Part 5.7B of the Corporations Act.

8. It is, ordinarily, appropriate for ASIC to require an IER as a precondition to a grant of relief in the context of other transactions regulated by Chapter 6 of the Corporations Act where the relevant shares have some intrinsic value, so as to ensure that the objects of Chapter 6 are observed, including that shareholders are given enough

information to enable them to assess the merits of the Chapter 6 transaction proposal.[1]

9. However, the transfer of shares pursuant to s444GA of the Corporations Act can be distinguished from most other Chapter 6 transactions by virtue of the fact it occurs in the context of an insolvent company where, in most instances, there will not be any surplus equity left for distribution to shareholders after satisfaction of the company's debts. In the absence of universal shareholder consent, the Court's leave is required, and the Court must not grant leave unless it is "satisfied that the transfer would not unfairly prejudice the interests of members". That means the Court cannot make orders unless either:

    (a) the members are being compensated; or

    (b) the Court is satisfied there is no value in the shares.

10. RG 111 requires substantial information to be included in an IER, much of which is focused on a standard Chapter 6 transaction where the shares in question have an intrinsic value and shareholders are being asked to accept or approve a transaction, rather than a s444GA transfer of shares in an insolvent company where shareholders may apply to the Court objecting to the transfer. In the former scenario, most shareholders will participate, whereas in the latter scenario, objections are likely to be limited to a few shareholders (if any).

11. The preparation of an IER poses a substantial additional cost to an insolvent company already under external administration which would not be outweighed by the benefit it provides.

12. Balanced against that cost is the prospective benefit provided by an IER. CP326 rightly asserts that an IER can assist shareholders to determine whether or not to object in a Court application under s444GA. However, that assistance can be provided by other means in the context of such an application.

Court protection and standard

13. In many circumstances, the administrator's report to creditors will provide adequate information to shareholders in considering whether or not to object to a s444GA transfer. For example, if an administrator of the relevant company has confirmed in his or her report to creditors under rule 75-225(3) of the *Insolvency Practice Rules (Corporations) 2016* (Cth) (**75-225 Report**) that the value of the company's business and assets is substantially less than its liabilities, it will be apparent that there is no prima facie value in the form of a surplus of assets.

14. The shares the subject of a s444GA transfer arguably may have some inherent value. This is evident from the sheer fact that such transaction is being conducted. However, based on the body of case law which has developed to date, it does seem that where there is a substantial deficiency of assets to liabilities, a Court will be relatively easily convinced to grant leave for the transfer of shares under s444GA. Consequently, where an administrator's report reveals such a material deficiency, it is difficult to see how an IER is necessary.

[1] Corporations Act, s602(b)(iii).

15. In the regulated space, s444GA transfers almost invariably occur pursuant to Court order under s444GA(1)(b) of the Corporations Act (that is, unanimous shareholder consent is virtually impossible to obtain due to the large number of shareholders).

16. Section 444GA(3) provides an important and broad safeguard to shareholders' interests in that the Court cannot grant leave to permit the transfer unless it is satisfied that the transfer would not unfairly prejudice the interests of shareholders. As noted in CP326, Courts have traditionally been satisfied with an administrator's 75-225 Report to creditors when considering the value (or absence thereof) of shares the subject of a s444GA transfer, and have not required an IER.

17. The value of a company's shares is equally relevant to the Court under s444GA(3) as it is to ASIC for the purposes of Chapter 6. Accordingly, the Committees consider that ASIC should adopt a consistent approach to that of the Courts.

When is additional valuation evidence required?

18. Notwithstanding the above, the Committees consider that expert valuation evidence may still be relevant for shareholders where there is a reasonable prospect that a surplus would exist for shareholders after satisfaction of the relevant company's liabilities.

19. Insolvency of a company is generally assessed from a cash-flow perspective rather than on a company's balance sheet. A company may end up in administration in circumstances where there is a temporary liquidity issue despite a surplus of assets.

20. Notwithstanding that there may be a surplus of assets, decisions in the voluntary administration process (including the question whether to execute a DOCA) are left to creditors. In circumstances where there is a realistic prospect of a surplus of assets, the Court may require the administrator to provide further valuation evidence to discharge their onus of proof that there is no unfair prejudice to the interests of shareholders. It is important that shareholders are appropriately informed with respect to any such evidence, as well as any valuation evidence from the administrators, when considering whether or not to object to a s444GA transfer.

21. Practical issues have arisen where administrators have sought to rely on IERs prepared in accordance with Regulatory Guide 111 in the Court process when seeking an order under s444GA. That type of IER is designed to meet ASIC policy requirements, not to meet the technical Court requirements for admissible expert evidence. The experts who prepare IERs for chapter 6 purposes are generally not accustomed to appearing in Court as an expert witness or familiar with those technical requirements. This has, on occasion, required substantial additional expense and time, to amend an IER after its preparation to seek to qualify it as expert valuation evidence for a Court. The Committees suggest that, where there is sufficient doubt as to whether there is a net asset deficit that valuation evidence beyond the administrator's own evidence is required, it is more preference for the further evidence to be based on the Court rules for expert evidence rather than an IER prepared in accordance with Regulatory Guide 111.

22. Where expert valuation evidence is to be provided, this should become apparent at directions hearings ahead of the main hearing, and it is appropriate that it be provided to shareholders prior to any substantive Court hearing. That way, shareholders' ability to object to a transfer is preserved.

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

23. As explained above, an IER is not necessary, but Court-admissible expert valuation evidence may be necessary where it is not sufficiently clear to the Court from the administrator's evidence alone that there is a net asset deficit and that shareholders' interests will not be unfairly prejudiced.

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?

24. As noted in paragraphs 13 and 14 above, in the bulk of circumstances, that approach will be sufficient.

Proposal B2: Basis of preparation of IER

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

25. The Committees agree that, if an IER is required as a prerequisite for granting relief, it is appropriate for the IER to be prepared on a liquidation basis only.

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?

26. Due to the nature of voidable transaction recoveries, in most circumstances, the total amount of the claim will not exceed the total amount of the company's debt. For example, the amount of a claim for insolvent trading would be set by reference to the amount of debt incurred whilst the company was insolvent and which remains unpaid in the liquidation. Likewise, the full amount of a preference claim should not logically exceed the amount of the company's debt.

27. For that reason, it would be very unusual for recoveries to give rise to a surplus of assets over liabilities. If there is a demonstrated likelihood of that occurring, quantification of such recoveries will be relevant for the independent expert's purposes.

28. Even if a possible surplus could be demonstrated, the ability to pursue claims successfully (whether through litigation or otherwise) and recover payment is inherently uncertain, and legal advice on the prospects of the claim would likely be necessary in order for an independent expert usefully to consider the claim value, which would in turn increase the cost of the administration.

29. Analysis of prospective voidable transaction recoveries are a necessary part of assessing a liquidation outcome and so it is appropriate that any independent expert take note of them. However, the Committees would encourage inclusion of some caution in the guidance against too heavy a reliance on that analysis, given the unlikelihood that such recoveries, when combined with proceeds recoverable from realisation of the company's other assets, will exceed the total amount of debt in such a way that there is a surplus of assets that would give rise to a distribution to

shareholders out of the liquidation. It might be appropriate for the threshold for an independent expert's consideration of likely voidable transaction recoveries to be set by reference to the standard required of voluntary administrators in a 75-225 Report, and indeed an independent expert should be able to use and rely upon the findings in an administrator's 75-225 Report for that purpose, to avoid an unnecessary overlap in work.

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

30. A going concern valuation would, in most instances, be of limited use to shareholders in considering whether or not to object to the transfer of shares under s444GA absent real prospects of the company being capable of operating as a going concern otherwise than by the relevant DOCA proposal in question.

31. In considering applications for leave to conduct s444GA transfers, the Courts have generally not required going concern valuations to be provided for their consideration. Further, certain Courts have expressed a view that going concern valuations can be of little or no value where the company in question is not operating as a going concern and could not fund day-to-day operations.[2]

32. The inclusion of a going concern valuation in an IER may in fact mislead shareholders. Without sufficient explanation, such a valuation could unjustifiably infer to shareholders that the relevant company is operating or could fund operations in circumstances where this is not the case and there is no reasonable basis for such an inference.

33. Relevantly, the Committees note ASIC's guidance that an expert's opinion in an IER should be based on reasonable assumptions and reasonable grounds.[3] Specifically, it should not include prospective financial information or any other statement or assumption about a future matter unless there are reasonable grounds for the forward-looking information, otherwise the opinion will be misleading.[4]

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

34. For the reasons outlined above, the Committees do not consider that, ordinarily, the going concern value is an appropriate method for valuing a company's shares in the circumstances.

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

35. The Committees do not have any submissions on potential additional factors which ASIC should consider when determining whether to grant relief.

[2] *Re Paladin Energy Ltd (Subject to Deed of Company Arrangement)* [2018] NSWSC 11, [7] per Black J.
[3] ASIC RG 111.74 and 111.90.
[4] ASIC RG 111.95.

Proposal B3: Appropriate person to be an independent expert

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

36. Administrators occupy a special position of independence despite being designated officers of the company to which they are appointed. Similarly, Courts have often accepted liquidators giving independent expert advice on solvency in their voidable preference claims (that is, to accept the evidence of the liquidator on a central question in the case before it even though it is the liquidator also prosecuting the claim.[5]

37. As pointed out in CP326, administrators owe their duties to the company, and not explicitly to creditors or shareholders. Administrators are used to balancing stakeholders' interests in their assessments of the manner in which the administration should proceed, notwithstanding that various stakeholders will have various different interests. For example:

    (a) Different classes of creditors have different interests in the outcome of an administration by virtue of where they rank in the priorities regime established under the Corporations Act. Secured creditors, employees, ordinary unsecured creditors and related party creditors all fare differently under that regime.

    (b) Some but not all stakeholders will have an interest in the continuation of a company's business. Employees' interests may not be limited to payment of entitlements, but also keeping their jobs.

38. Shareholders' interests have a priority under that regime which sits below all creditors. Although the nature of a shareholders' interest is different at law to that of a creditor, it is difficult to see why, at a policy level, the protection of their interests necessarily requires the advocacy of an independent person when all other stakeholders' interests can be effectively balanced by an administrator under the regime.

39. The independence concerns outlined in paragraph 35 of CP326 might be misplaced. They are examples of conflicts of interest between an administrator's own interests and those of other stakeholders in the company. That various stakeholders' interests conflict is almost a certainty. Unless there is a real material benefit to introducing additional external parties to an administration, that benefit will be outweighed by the increase in costs (and consequently a lower return to stakeholders) and additional delay.

40. Of course, independence is not the only consideration. If an administrator or another person from the administrator's firm is to prepare an IER, the person needs to be a competent person for that purpose. It may be that the administrator does not have the requisite skills or capacity to be an independent expert and, in that circumstance someone else should prepare the report.

[5] See, eg, *Lewis, in the matter of Damilock Pty Ltd (In Liquidation) v VI SA Australia Pty Ltd* [2008] FCA 1801.

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

41. For the reasons outlined above, the Committees consider that, in the context of an administration, the administrator may often be an appropriate person to prepare the report.

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?

42. As set out above, the Committees consider that, in the context of an administration, the administrator or another person from the administrator's firm may often be an appropriate person to prepare the report.

Conclusion and further contact

43. The Committees would be pleased to discuss any aspect of this submission.

44. Please contact the chair of the Insolvency and Restructuring Committee, Scott Butler on [redacted] or [redacted], if you would like to do so.

Yours faithfully,

[redacted]

Greg Rodgers
Chair, Business Law Section