ASIC FLAGS WELCOME GUIDANCE FOR LISTED COMPANY RESCUE DEALS

28 February 2020 | Australia
Legal Briefings – By **Rebecca Maslen-Stannage and Michael Compton**

ASIC is consulting on guidance which would simplify corporate rescue deals for listed companies through the 'DOCA takeover' mechanism pioneered in the Mirabela and Nexus Energy deals.

IN BRIEF

• Since the law was changed more than 10 years ago, it has been possible to take over an insolvent listed company in a distressed situation by agreeing a deal with the administrators through a deed of company arrangement or 'DOCA'. This was pioneered in deals such as Mirabela and Nexus Energy.
• These deals need specific relief from ASIC under the takeovers rules. There is no automatic exemption as there is for other deal structures like schemes of arrangement.
• Until now, ASIC has required a 'takeovers-style' independent expert report – including a theoretical going concern valuation of the company as part of that relief process, even when the company had no funding to operate as a going concern. While a liquidation value could also be included, this form of report risked causing confusion and false hope to shareholders.
• ASIC is consulting on whether it should soften this approach, including not requiring a going concern valuation.

RESCUE DEALS AND TAKEOVERS RULES

Administrators have the power, with court approval, to sell the shares in an insolvent company to a new buyer under a DOCA – an arrangement approved by creditors. The DOCA process enables the debts of an insolvent company to be compromised so that the bidder acquires a solvent company. Court approval is required for a DOCA takeover (under section 444GA of the Corporations Act) and the courts will only approve this type of deal if satisfied that it does not cause unfair prejudice to shareholders. If shareholders would not receive any return on a winding up of the company – ie there is no residual value in their shares – they are not unfairly prejudiced by the administrator selling their shares for the benefit of creditors.

Several listed companies have successfully executed DOCA takeover transactions (eg Mirabela Nickel (2014), Nexus Energy (2014), Ten Network (2017), Paladin Energy (2018) and Oroton Group (2018)). The takeovers rules in the Corporations Act prevent a new owner acquiring more than 20% of the insolvent company as part of any rescue deal. There is no specific exception from the takeovers rules for transfers of shares under a DOCA, so specific relief is required from ASIC to implement these deals.

ASIC'S APPROACH TO DATE

ASIC has, to date, required a takeovers-style independent expert's report including a valuation of the insolvent company on a going-concern basis to be sent to shareholders. In preparing the going concern valuation, the expert is required to assume the company is not in financial distress and the transaction is occurring between a knowledgeable and willing, but not anxious, buyer and a knowledgeable and willing, but not anxious, seller, acting at arm's length. The expert can – and does – then bridge from that valuation to a liquidation valuation, on the basis the company is not in fact a going concern. However, the 'going concern' aspect has at times both confused shareholders and provided ammunition to shareholders who wish to pressure the bidder to provide some value for them.

This has added to the cost and implementation risk of DOCA takeovers. There is a tension between requirements to protect shareholders and the goal of optimising the outcome for creditors, which rank ahead of shareholders and are necessarily (given the insolvency) not being paid what they are owed in full.

The courts have queried whether a going concern valuation is relevant or helpful in these circumstances, where the real test of whether shareholders would be unfairly prejudiced is whether there is any residual value in their shares on a winding up scenario.

PROPOSED ASIC APPROACH

Based on the deal experience to date and input from the courts, ASIC is proposing new guidance, in which it may not require a going concern valuation for future DOCA takeovers. ASIC would instead accept a valuation prepared on a liquidation-only basis, for the purposes of granting relief from the takeovers rules.

ASIC is proposing to still require an independent expert's report to be prepared and distributed to shareholders prior to seeking court approval in connection with the 444GA transfer.

ASIC has also indicated that it still intends to require that the valuation is prepared by an 'independent expert' who is independent of the administrator (applying the usual takeovers law concept of independence in RG 112).

ANALYSIS

The move away from requiring going concern valuations to be provided to shareholders in this context (in addition to a liquidation valuation) is a welcome development. Where the equity in the company has been lost, the company is not a going concern.

Unlike a classic takeover situation, for a company in administration (whose only alternative to a DOCA is a liquidation), providing a going concern valuation to shareholders runs the real risk of confusing or misleading shareholders, rather than informing them. A going concern valuation which indicated value in shares on a (false) assumption that the company could continue as a going concern risks suggesting to shareholders that they have a valid basis to oppose the DOCA takeover in court, and providing ammunition to greenmailers seeking to extract strategic value to the detriment of creditors and the efficient functioning of the insolvency regime.

ASIC has indicated that it proposes to still require the valuation to be prepared by a 'takeovers style' independent expert who follows its regulatory guidance for the preparation of independent expert's reports in the takeovers context.

There is a need for checks and balances in DOCA takeovers. A company becomes insolvent if it cannot pay its debts as and when they fall due. This means a liquidity crunch can send a company into insolvency even if it has positive net asset value. So the court, in assessing whether shareholders are unfairly prejudiced, is effectively checking that shareholders are not being deprived of net asset value in the company.

However, given the distressed context where there is generally not enough value to cover debts, we favour the court process providing the checks and balances to the maximum extent practicable.

The administrator needs to provide valuation evidence to the court to support the required court order. Where, for example, it is readily apparent that the company is in an asset deficit position, the court may be quite prepared to accept that evidence from the administrator itself. Where the administrator has run an appropriate sale process for the company's assets, the bid values provide more realistic and relevant evidence of value than a theoretical DCF valuation.

The courts are well placed to test the evidence, including any independence concerns with respect to the witnesses providing that evidence. In a pragmatic insolvency context, the cost of additional measures, like requiring an independent expert's valuation even where the court does not see that as necessary for it to form a view on whether there is unfair prejudice, may outweigh their benefit.

NEXT STEPS

ASIC's consultation closes on 28 February 2020. We welcome the opportunity ASIC has provided for submissions on this proposal and will be making a submission to ASIC on the points above.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

REBECCA MASLEN-STANNAGE
PARTNER, SYDNEY

+61 2 9225 5500
Rebecca.Maslen-Stannage@hsf.com

MICHAEL COMPTON
SENIOR ASSOCIATE, SYDNEY
+61 2 9225 5169
Michael.Compton@hsf.com

LEGAL NOTICE

The contents of this publication are for reference purposes only and may not be current as at the date of accessing this publication. They do not constitute legal advice and should not be relied upon as such. Specific legal advice about your specific circumstances should always be sought separately before taking any action based on this publication.