Listed Public Companies in Insolvency: The Mothercare Administration

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Introduction

Listed public companies in insolvency present particular challenges in conserving and extracting value for creditors, and in some cases, shareholders.

The complex regulatory regime imposed by the Listing Rules of the Australian Securities Exchange ("ASX"), the Corporations Act 2001 (Cwth) ("Corporations Act") and Takeovers Panel Guidance all have to be navigated in addition to the Corporations Act provisions that apply to all insolvent administrations.

Gavin Robertson, providing legal advice and Antony Resnick as joint and several Administrator recently dealt with many challenges during the voluntary administration of Mothercare Australia Limited.

In this paper we analyse the issues from the Mothercare administration, and provide practical guidance on issues that can arise in the insolvent administration of listed public companies.

Background

Mothercare Australia Limited was a public company listed on the Australian Securities Exchange. They retailed maternity wear, babies and children's fashion, educational toys and nursery equipment.

Mothercare struggled to establish in Australia in a difficult retail environment. Despite a rescue attempt by the directors, Antony Resnick and Brian Silvia were appointed joint and several Administrators on 29 January 2013.

The Administrators conducted an extensive campaign to sell the business as a going concern. When no buyers emerged, the company's stock and other assets were sold.

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Once all assets had been sold, the listed parent entity was made subject to a Deed of Company Arrangement (DOCA). This resulted in:

- salvage of the listed entity for a potential back door listing;
- potential return of value to shareholders: and
- realisation of additional value for all classes of creditors.

When administration is imminent

Many different circumstances can prompt the directors to call in an Administrator:

- the company's auditors may prompt it when considering if a company's accounts can be prepared on a "going concern" basis;
- actual or threatened demand for payment that cannot be satisfied;
- cash flow forecasts which demonstrate the company will be unable to pay creditors; or
- as in the case of Mothercare, the failure of a rescue attempt.

Whatever prompts the appointment, directors of listed public companies, in addition to dealing with the usual issues relating to avoiding preferences and insolvent trading when administration is imminent, must have regard to the company's continuous disclosure obligations.

Under Listing Rule 3.1, a listed company is required to announce to the market, all information expected to have a material effect on the price or value of a company's securities. This includes that the directors are considering appointing an administrator.

ASX Guidance Note 8 recognises that disclosure of such circumstances may create difficulties and states:

> "…the proper course for the entity in such a situation is not to disregard its continuous disclosure obligations but to approach ASX to discuss the possibility of a trading halt or, if the situation is unlikely to resolve itself within two trading days, a voluntary suspension."

In the Mothercare case, the company was granted a voluntary suspension to permit the rescue to be undertaken meaning there was no need to address this issue once the need for the appointment of an administrator arose.

However, where the issue arises and the entity's securities are still being traded, it is essential that a trading halt or voluntary suspension be sought, so directors can properly consider their obligations where the company's shares are not still being traded and the market is unaware of the company's true financial position.

In any event, an ASX announcement must be made as soon as any appointment is made, following which the company's securities will be or remain suspended.

Compliance with Listing Rule 3.1 is required by law, and is one of a number of necessary steps to ensure the listed entity remains in good standing with ASX, leaving open the option of realising value from the ASX listing for the benefit of creditors and possibly for shareholders.

During the course of administration

Listing Rule 3.1 must also be considered during the course of administration. Guidance Note 8 states at paragraph 4.23:

> "Where an entity is subject to a longer term suspension (eg. as a result of an administration or liquidation) ASX recommends that it implement a system of periodic (monthly or quarterly) disclosures to ensure that the market and its security holders are provided with regular updates as to its status and, in particular, the plans it may have for trading in its securities to resume and its progress in implementing those plans."

This guidance needs to be considered in the context of Listing Rules 3.1, which only requires disclosure of information which has a material effect on the price or value of the entity's securities. Where the entity is clearly insolvent, as was the case with Mothercare, there is no value in the entity's securities. The view was taken that it was unnecessary to make ASX announcements during the course of administration until a DOCA was approved by creditors which would, if completed, have the potential to return value of the company's securities.

A listed public company is theoretically required to comply with all ASX Listing Rules during the course of administration, not just Listing Rule 3.1. Consideration must be given to Listing Rule 11.2 which requires shareholder approval for an entity to dispose of its main undertaking. This issue did not arise in the Mothercare administration as there were no buyers for the business, resulting in closure and sale of stock and assets.

If a buyer had been found, we would have had to consult with ASX in relation to Listing Rule 11.2. In normal circumstances the ASX does not require shareholder approval as this unreasonably impedes the administrator's right to dispose of the business for the benefit of creditors in circumstances where the shareholders had no economic interest in the business because of the entity's insolvency. Nor would ASX ordinarily require the formality of waiver application for the sale to proceed.

However if the sale occurred in the broader context of a recapitalization of the company pursuant to a DOCA, resulting in the re-quotation of the company's shares on ASX and the return of value to shareholders, shareholder approval may be required. This scenario is discussed further in this paper.

ASX is flexible with respect to a company's periodic disclosure obligations under Chapter 4 of the Listing Rules (quarterly, half yearly and annual disclosure). However ASX will insist on compliance with certain ongoing requirements.

It is necessary to pay ASX's annual listing fee to maintain the listing. Annual fees are payable in advance for the year from 1 July to 30 June and are required to be paid by 31 July. The entity will be removed from the Official List if it is not paid by the 20th business day after the due date.

In the Mothercare case the proponent of the DOCA elected not to pay the listing fee and the company was removed from the Official List, thereby simplifying the requirements for shareholder approval required as a condition of completing the DOCA. This is discussed in further in the next page.

ASX has permitted entities which are suspended from quotation to remain listed for extended periods. However, ASX is currently reviewing its policy with a view to having suspended entities automatically delisted where they have been suspended continuously for three years. If the policy does alter, it should only affect those companies subject to complex extended administrations. In such cases it might be expected that ASX would be prepared to maintain the listing to permit a reconstruction to occur outside the three year period.

Reconstruction options

There are a number of reconstruction options available for public companies which can enhance the return to creditors and potentially return value to shareholders.

1. Sell all shares and surrender listing. Following closure of the business and sale of stock and assets, there still remained realizable value in Mothercare in the form of franking credits. We discussed the potential purchase of the whole entity which, had it proceeded, would have required the purchaser to acquire all of the issued shares in the capital of the company.

Section 444GA(1) of the Corporations Act permits the administrator of a DOCA to transfer shares in the company if written consent of the owner or leave of the Court is obtained. In this instance the written consent of owners was impractical. However it is likely that the leave of the Court would have been obtained as the result of the sale of the shares would have been to improve the return to creditors.

However Section 444G does not operate to the exclusion of the operation of Chapter 6 of the Corporations Act, which would have made it unlawful for the purchaser to acquire more than 20% of the Company's issued capital without complying with Section 611. That is, most relevantly without having either made a takeover offer for the shares or acquired its interest pursuant to a Scheme of Arrangement. Either course would have been difficult to implement and prohibitively expensive in the context of the realizable value of the underlying franking credits.

For this transaction to proceed we had to obtain relief from ASIC from the application of Chapter 6 to the transfer of the shares.

We had preliminary discussions with ASIC who indicated this may be possible, particularly as Court approval would be required under Section 444GA. However as this transaction did not proceed, this will need to be more fully explored with ASIC on the next occasion.

2. Back door listing. A further option is to use the listed vehicle for a back door listing. This is generally available where the business of the entity has been sold or closed down and the entity has some attractive feature, such as a very large number of shareholders or, as with Mothercare, franking credits. A party interested in using the vehicle for a back door listing could propose a DOCA which involves the contribution of capital to the company to be paid into a creditors trust with the following conditions requiring shareholder approval:

- under Listing Rule 7.1 if the capital represented more than 15% of the company's issued shares at the commencement of the twelve month period prior to its contribution;
- under Section 611 Item 7 of the Corporations Act if greater than 20%;and
- under Chapter 2E if greater than 25%.

Listing Rule 7.1 requires that shareholder approval is obtained where a listed company proposes issuing more than 15% of its issued capital as at the commencement of a 12 month period immediately prior to the contribution of the capital. ASX Listing Rules require the disclosure to shareholders of certain information, such as the number and terms of the securities to be issued, together with the intended use of the funds raised.

Listing Rule 7.1 approval is not required where approval is obtained for the purposes of Section 611 Item 7 of the Corporations Act. This section permits a party to acquire a relevant interest in more than 20% of a regulated company's issued capital where shareholder approval is obtained. ASIC provides guidance as to the information required to be disclosed to shareholders which includes an Independent Expert's Report as to whether the proposal is fair and reasonable to the non-participating shareholders.

Chapter 2E requires that shareholder approval be obtained where a public company provides a benefit to a related party. A related party includes a party that is expected to gain control of the entity. Control is considered to be triggered where more than 25% of the issued capital is acquired. ASIC guidance requires that the benefits given to the related party be valued. This would typically be done in the context of the Independent Expert's Report required under Section 611 Item 7.

In all three instances the notice of meeting is required to include a voting exclusion statement which would prevent the proponent of the DOCA from voting on the proposal.

In the Mothercare case the proponent contributed cash to the company in the form of a loan and capital. The capital component resulted in the proponent acquiring a 19.9% interest in Mothercare's issued capital and diluting the other shareholders. Accordingly shareholder approval would only have been required for the purposes of Listing Rule 7.1, except that the proponent elected not to maintain the listing, thereby simplifying the approval process.

The proceeds of the loan and the capital were paid by direction to a Creditor's Trust for the benefit of all classes of creditors. On completion of the DOCA all of the Company's debts were extinguished (except for the loan contributed by the proponent) and any remaining assets and claims were transferred to the creditors trust for the benefit of the creditors. The terms of the trust were such that each class of creditor will participate in the distributions from the Creditors Trust.

In the Mothercare case the proponent did not intend to introduce a new business to the entity immediately. Had it done so it would have required additional shareholder approval for the purposes of Listing Rule 11.1. Shareholder approval is required under Listing Rule 11.1 if there is a proposal to make a significant change to the nature or scale of the entity's activities. ASX would generally require the entity to re-comply with the requirements in Chapters 1 and 2 of the ASX Listing Rules, as if the entity were applying for admission to the Official List for the first time.

As mentioned, an entity is only considered suitable for a back door listing if it had some attractive feature like the availability of franking credits as in the Mothercare case.

3. Recapitalise and relist. Where an entity has failed due to undercapitalization, an option is to capitalise the debt either in whole or in part. If in part for balance of the debt to be extinguished, under a DOCA.

In that case creditors would receive shares in the entity in exchange for all or a proportion of their debts.

Depending on the proportion of the entity's shares to be issued to creditors, and on whether any one or associated group of creditors acquired more than a 20% or 25% interest in the diluted capital of the entity, any one or more of the shareholder approvals outlined above could be required.

An entity in these circumstances could raise working capital through a public offering or a rights issue to existing shareholders. If a rights issue was adopted, this would need to be supported by those creditors who had had their debts capitalised, which would require cash contributions from them.

Variants

There are a number of variants on the preceding scenarios. For example:

- the existing business could be maintained and an additional business (presumably compatible with and adding synergy to the existing business) could be introduced in combination with a recapitalization of the entity;
- the existing business could be sold as a going concern in conjunction with and conditional on the introduction of a new business by way of a back door listing. In such circumstances it is likely ASX would require shareholder approval under Listing Rule 11.2 as this would amount to a disposal of the entity's main undertaking as part of a broader transaction, as distinguished from the disposal of the entity's main undertaking by the administrator in the course of realising assets for the benefit of creditors.

Conclusion

- Where a listed public company is confronting administration, the directors, must comply with ASX Listing Rules, particularly around continuous disclosure obligations.
- During the course of administration it is necessary to consider what value may be extracted from the fact that the entity is listed, principally for the benefit of creditors, but also what residual value may be available to shareholders.
- While not all listed entities provide any value for back door listing, some do, as was the case with Mothercare. Others may continue trading by being recapitalised under a Deed of Company Arrangement and by raising additional working capital.
- The Mothercare Administration required that a range of complex issues be navigated in order to achieve a favourable result for creditors, which resulted in:
    - Dividends being paid to all creditors; and
    - Prospects for shareholders to extract value in due course.

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