Compulsory divesting of members' shares under a deed of company arrangement

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Introduction

Recently the deed administrators of uranium miner Paladin Energy Ltd obtained leave of the Court to transfer 98% of shareholders' shares for no consideration to certain parties participating in a debt capital raising undertaken by the company: see *In the matter of Paladin Energy Limited (subject to deed of company arrangement)* (2018) NSWSC, 18/1/2018.

Such compulsory divesting of shares for no consideration with leave of the court reinforces the effectiveness of deeds of company arrangements as a means of extracting value for a company's creditors through restructuring its share capital under a recapitalization plan.

Divesting shares for no consideration under the terms of a DOCA, often opposed by shareholders, appears on its face to be a drastic measure for a deed administrator to adopt. For this reason, it is appropriate to have a closer look at the justification for such decisions, and the operation of Corporations Act provisions that allow compulsory divesting to occur.

Background

Following the introduction of the administration process into the Corporations Act doubt arose as to whether the statutory powers granted to a DOCA administrator allowed for the disposal of existing shares in the company for no consideration against the wishes of the holders of those shares. In early cases, the courts formed the view that a deed administrator could not bind a shareholder to the confiscation of his or her shares if the shareholder did not consent: see *Mulvaney v Wintulich*, unreported, Federal Court of Australia, O'Loughlin J, 29/9/1995.

In light of the early position adopted by the courts s 444GA was introduced into the Corporations Act providing the administrator with power to transfer shares in a company with either the consent of the holders of the shares or with leave of the court in the absence of consent. By way of safeguard ss 444GA(3) further provided that the court may only grant leave if satisfied that "the transfer would not unfairly prejudice the interests of members of the company."

In *Weaver v Noble Resources Ltd* (2010) WASC 182, an early case dealing with the new provision, the Court observed that the purpose of the section was to enable a deed administrator to transfer shares in the company without consent of shareholders where such a transfer was necessary for the success of the DOCA. Moreover, for the purposes of the safeguard extended to members under ss 444GA(3), the Court accepted that a mere transfer of shares without compensation did not constitute "unfair prejudice" if the shares to be transferred had no value.

Cases where s 444GA may be effectively employed by DOCA administrators

The following scenarios are typical of those that may be encountered in court applications under s 444GA.

- A proposal under a DOCA for capital investment on terms, inter alia, that all existing shares be transferred to the investor. Here the investor is unwilling to invest in the company without being granted control of the issued shares. In Weaver v Noble Resources Ltd (above) the Court also recognized the free-rider implications of the investment:

“The recapitalisation, in order to be undertaken, would require the provision of a benefit to flow to the investor who takes the risk involved in injecting further capital into a project that has already revealed the risks of such a course. It would be extremely unlikely for an investor to take that risk on the basis that existing shareholders (whose risks of ownership and investment have already materialized and resulted in the loss of all value) could receive some free-carried benefit from further investment in which they take no risk.”

- Capital restructuring under a DOCA by means of an exchange of debt for equity. For example, a bank creditor may be willing to exchange debt owed to it on acquiring the existing shares in the company.
- In order to effect a sale transaction under a DOCA a willing buyer of the insolvent company’s business seeks to acquire 100% ownership of the company’s existing shares rather than taking a transfer of its assets.
- An investor, pursuant to a DOCA proposal, is willing to pay a cash contribution to be distributed among creditors of the company so as to ensure a return to creditors of a specified amount in the dollar. The contribution is subject to the investor acquiring all existing shares in the company.

In each of the above scenarios, DOCA proposals are unlikely to proceed without the divesting of existing shares in favour of the party participating in the proposal. To achieve this, DOCA administrators may exercise the power to transfer existing shares for no consideration with shareholders’ consent. In the absence of consent, the alternative route of an application to the court under s 444GA may be instigated. In that event, the DOCA administrator will seek a court order overriding dissenting shareholders’ objections. In doing so the administrator will bear the onus of satisfying the court that the proposed transfer under the DOCA does not involve unfair prejudice to shareholders.

At this stage, the meaning of the phrase “unfairly prejudice the interests of members of the company” warrants further consideration.

Protection afforded to dissenting shareholders

Following the introduction of s 444GA into the Corporations Act several cases have addressed the operation of ss 444GA(3), and in particular the notion of unfair prejudice to members.

The courts have consistently recognized that where shares, due to the financial position of the company, have no value then to divest them for no consideration does not constitute prejudice to their holders, let alone unfair prejudice. Moreover, the courts have been concerned to ensure that DOCA proposals are not undermined by shareholder “blackmail” with dissenting shareholders refusing to transfer their shares having only tactical value but not economic value.

The notion of unfair prejudice was usefully reviewed by the Court in *Lewis, Re Diverse Barrel Solutions Pty Ltd* (2014) FCA 53 where regard to the following was seen to be relevant:

- Whether the shares have any residual value which may be lost to the existing shareholders if leave is granted. This enquiry as to residual value will usually consider the position of shareholders in the event of winding up and the likelihood of a return on their shares in those circumstances.
- Whether there is a prospect of the shares obtaining some value within a reasonable time.
- The steps or measures necessary before the prospect of the shares attaining value may be realized.
- The attitude of the existing shareholders to providing the capital contributions by which the shares may obtain some value or by which the company may continue in existence.

In the absence of statutory attempts to define “unfairly prejudicial”, it is understandable that the courts have relied on guidelines of the kind arising in the DBS decision.

Additional considerations where a listed company, or unlisted company with more than 50 members is involved

With respect to companies to which Chapter 6, Corporations Act applies (a listed company or one with more than 50 shareholders) questions have arisen as to whether compulsory acquisition of shares under s 444GA interacts with the 20% prohibition (takeovers prohibition) that applies to such companies by virtue of s 606, Corporations Act.

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prohibition (takeovers prohibition) that applies to such companies by virtue of s 606, Corporations Act.

On a number of occasions ASIC has granted exemptions to allow share transfers for which the court gave leave under s 444GA but which would otherwise have contravened the 20% takeover prohibition. Recently ASIC exemption was obtained in *In the matter of Ten Network Holdings Limited (subject to a deed of company arrangement)* (2017) NSWSC 1529. In granting relief to the s 606 takeover prohibition ASIC recognized that matters relevant to the Court's decision under s 444GA were "potentially overlapping" with criteria relevant to the ASIC exemption decision (para.14).

Concluding comments

As a general proposition, property rights in shares are recognized and protected at law as being inviolable. However, it is also recognised that shareholders are largely excluded from decision-making in the administration process, and the interests of shareholders in their insolvent company deferred in favour of the interests of creditors.

Our discussion reveals that s 444GA was introduced to give deed administrators power to transfer shares in the interests of creditors with either the consent of members or with leave of the court in the absence of consent. The section recognizes that such a power will often be essential to the success of a DOCA where, for example, an investor's contribution under a DOCA proposal is premised on the precondition of acquiring all the existing shares in the company for nil consideration.

The effect of s 444GA is consistent with the statutory objectives of the administration process under Part 5.3A, Corporations Act, and ensures that shareholders are limited in their ability to impede creditor supported DOCA proposals where their shares demonstrably have no economic value.

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