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ARTICLE

An Administrator's Power to Compulsorily Transfer Shares[1]

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Introduction

The compulsive power of the Court to transfer shares upon a deed administrator's application[2] has the potential to interfere considerably with shareholders' proprietary rights. In light of its significance, there is surprisingly little discussion regarding the scope and ambit, or limitations upon, the exercise of the power and only one (unreported) decision of the Supreme Court of Western Australia providing any guidance as to when such applications will succeed.[3]

Presumably this is because the power will mostly be exercised in circumstances where no value remains in shares if the value of debts exceed asset values. This is known as the Debt Residual Value, or 'DRV' in the shares.

This article discusses another formulation of the relevant test, that is considering whether, on the guidance offered by section 444GA(3), there are circumstances where the proper test is to consider the inferred value of the shares, having regard to both to the DRV and to the company's growth prospects post project (Contingent Residual Value, or 'CRV'). The question is of relevance because in many circumstances of near-insolvency, parties may propose a project or restructure aiming to revive the company. Sometimes, the circumstances that have led the company into administration are not terminal in the sense that a capital raising or other program might have been available to cure liquidity concerns, but the directors were either not confident of the success of the capital raising or were not prepared, on the present state of our insolvent trading laws, to expose themselves to personal liability for trade debts if the capital raising failed.[4] Whatever the reason for the appointment of administrators, if a rehabilitation can be successfully undertaken, existing equity in the business (shares) will retain some value.

The capital raising will have some dilutive impact on the value of shares, but the essential point is that whereas a DRV would have yielded a nil value on day one of the administration, the CRV would yield something more, and would be assessed having regard to the contingencies attending the capital raising program. Distilled to its essence then, our question is whether the potential value to shareholders of the company's projects should be a relevant consideration?

Potentially 'yes', though in most cases the DRV and CRV analysis will yield much the same outcome unless the shareholder is prepared to fund any required capital raising to satisfy existing unfunded obligations (ie: to bring what remains of the company out of administration using an appropriately structured debt management program incorporated in a deed of company arrangement).

However, there are circumstances where the CRV will, in circumstances where shareholders hold other economic interests in a project dependent on the shareholding interest or in the company itself, be the applicable test. In those circumstances, emphasis on the meaning of 'unfair prejudice' to members' interests within s444GA(3) may lead to a result where the CRV has some inferred value above nil, requiring the Court to value the economic interests of the member before deciding whether to grant leave to confiscate their property under s444GA.

A Power of Transfer – section 444GA

Section 444GA[5] provides that a deed administrator may transfer shares in a company with consent of the owner or with leave of the court.

Notes

1 Originally published by Cameron Belyea, partner of Clayton Utz and Tracy Chew, associate of Clayton Utz in *Insolvency Law Bulletin*, 2010, Vol 10, No 7 (March), revised for inclusion in this publication (April 2011).
2 Section 444GA of the Corporations Act 2001 (Cth).
3 *Weaver and others as Joint and Several Deed Administrators of Midwest Vanadium Pty Ltd v Noble Resources Ltd* [2010] WASC 182.
4 Treasury released a white paper calling for submissions on amending the law to incorporate, inter alia, a modified business judgments rule to provide certain safe harbours in favour of directors of financially stricken entities making business judgments with the assistance of appropriate financial advisors. Submissions closed on 2 March 2010.
5 Section 444GA was inserted by item 29 of the Corporations Amendment (Insolvency) Bill 2007 and took effect on 31 December 2007.

Before its insertion, deed administrators lacked power to sell shareholders' shares without their consent.[6] Section 444GA was inserted because, inter alia:[7]

- it may be essential to a DOCA's success that a share sale proceeds, e.g., a DOCA based on an investor acquiring all (or a minimum proportion) of the company's shares in return for a lump-sum payment to creditors; and
- often, the shares of a company under administration will have little residual value and shareholders will not participate in distributions, therefore, arguably, their consent to the transfer is not required.

The Explanatory Memorandum recognises that such power may be open to abuse, in particular:

- a DOCA involving creditors swapping their debt for equity may unfairly advantage creditors if the company's underlying business is strong; and
- such power could unfairly prejudice shareholders where the company retains some residual value.

Accordingly, section 444GA(3) provides:

> 'The Court may only give leave under subsection (1) if it is satisfied that the transfer would not unfairly prejudice the interests of members of the company'.

In assessing whether a member is 'unfairly prejudiced' by the proposed share transfer, the court must consider the impact of a compulsory share sale *where there may be some residual value in the company*.[8] In *Gambotto*,[9] the High Court (commenting generally on shareholders' rights in compulsory acquisitions) suggests that a high standard of proof will be required to establish the consideration payable to the shareholder at least meets the 'residual value' of the shares before a Court can forcibly confiscate shares.

On standard statutory interpretation principles, it is instructive that the expression 'unfairly prejudicial' also finds voice in Pt 2E.3. There, the Court has broad powers to adjust the rights of members, or even to wind up the corporate structure where some impugned conduct is 'oppressive to, unfairly prejudicial to, or unfairly discriminatory against' a member 'whether in that capacity or in any other capacity'.

Section 444GA(3) uses a slightly different formulation, requiring the Court to have regard to 'the interests of members', without necessarily limiting that 'interest' to 'shareholding interests'. It would seem to follow, and this is an analysis consistent with Pt 2E.3 that in considering whether a compulsory transfer is 'unfairly prejudicial', the Court ought consider all economic interests of the member in an entity and have regard to the totality of those interests in determining the 'residual value' of the shareholding.

Residual value

Where the company is insolvent in the sense that the company has no ability to continue to use its assets or associations with stakeholders to fund ongoing operations, shareholders are no longer residual claimants and their residual interest is zero.[10] In those circumstances, 'residual value' in insolvency relates to available assets rather than potential future assets or earnings.

More generally, the residual interest of a company to its shareholders, in accounting terms, is the surplus of assets over liabilities. In finance circles, residual value for an insolvent company is typically 'what's left after all definite obligations have been satisfied'.[11]

The DRV appears to accord with the general accounting and finance usages of residual value. Arguably the legislation intended for it to be more difficult to establish unfair prejudice, as section 444GA(3) refers to members in the plural rather than the singular.[12] Adopting the DRV would be consistent with this. It was the approach taken in the *Windimurra* decision, Martin CJ opining:

> '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 materialised and resulted in the loss of all value) could receive some free-carried benefit from further investment in which they take no risk.'

Notes

6 *Mulvany v Wintulich* (unreported, Fed C of A, O'Loughlin J, SG 3184 of 1995, 29 September 1995, BC9507148); *Cresvale Far East Ltd (in liq) v Cresvale Securities (subject to DCA)* (2001) 37 ACSR 394.
7 See paragraphs 7.49 to 7.59 of the Explanatory Memorandum to the Corporations Amendment (Insolvency) Bill 2007.
8 See paragraph 7.58 of the Explanatory Memorandum.
9 *Gambotto v WCF Ltd* (1995) 182 CLR 432.
10 Dr Colin Anderson and Dr David Morrison, 'Seen but not heard? The significance of shareholders under Pt 5.3A of the Corporations Act' (2008) 16 *Insolv LJ* 222.
11 Financial Innovation in Corporate Law, quoting Robert Charles Clark, Corporate Law (1986) at 18.
12 Supra n. 10; section 232 of the Corporations Act which refers to 'a member or members'; section 445D(1)(f) of the Corporations Act which refers to 'one or more such creditors'.

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Adopting this as a general statement would mean that most, if not all, section 444GA applications involving balance sheet negative assets will be successful. It is respectfully suggested that Martin CJ was not intending in *Windimurra* to outline an absolute test, but instead a test that, on the circumstances there before the Court, indicated that the shares in the company 'had no value'.

An absolute test based on balance sheet deficiency would make it easier for administrators to compulsorily transfer shares to remove any blocking stakes to projects which may be crucial to the company's continued survival. In most administrations, the necessity for an external project only arises if the company will have no or minimal residual value without such a project.

Indeed it is fair to say that in most administrations, DRV will be negative or zero and hence the same sort of result as was delivered in Windimurra would presumably be delivered on future applications of this nature.

However, it seems inappropriate for DRV to be commensurate with 'unfair prejudice' in all cases involving insolvent companies. It would mean that almost every section 444GA application would be approved. This would render section 444GA(3) of little value except in those relatively rare cases where a company placed into administration because of cashflow problems still retains an excess of assets over liabilities.

The converse (that the CRV would mostly be positive) is not the case if appropriate discount factors are applied. That is, if a contingency is, e.g., a condition that the investor obtain 100% control (and this condition is not expected to change), then the discount factor would be zero, as there would be no chance of the contingency occurring, or even if it does, shareholders would achieve no value from the project as they would no longer own any shares. Such application of the discount factor would resolve the anomaly in adopting the CRV that a shareholder can obtain value from a project which requires 100% investor ownership of shares. However, the CRV approach affords higher protection to shareholders as, if there is a chance of the deal succeeding without the share transfer, some residual value to shareholders will still remain.

The CRV approach is not without difficulties. How should the discount factor be calculated? Attributing a number to the probability of contingencies occurring may require expert consideration, which may entail higher costs an insolvent company may not be able to afford. The probability of a contingency, e.g, an investor agreeing to invest or secured creditors approving the proposal, largely depends upon the circumstances of the companies involved, much of the details which are known only to that company. Therefore, computing the probability of a project succeeding is highly subjective and prone to information asymmetries which may make the exercise potentially inaccurate.

Also, the likelihood of contingencies occurring will probably change over time as circumstances change. There needs to be a time frame on the assessment of the CRV, or re-evaluation of discount factors over time. Will the administrator decide on these notional dates for re-evaluation, and how are they to be decided (e.g. a date following an extensive sales campaign)?

Although the CRV appears to be, theoretically, a more realistic approach to shareholder value, the open-endedness of the above issues may make it practically difficult for the court to accept such approach to residual value.

Oppression remedies

Further guidance on defining 'unfair prejudice' may be drawn from the application of the oppression remedies under sections 232 and 233 of the Corporations Act, which provides members with statutory remedies if the actions of the company are, inter alia, unfairly prejudicial to a member (section) of the company.

'Unfairness' in section 232 is assessed against commercial unfairness, which includes a lack of reasonable commercial justification for the course taken.[13] Applying this test may make it difficult for shareholders to allege unfair prejudice in an administration, as share transfers are usually justified for the purposes of securing investor participation in a project which will aid the continuation of the company's business, which the administrator is directed to give primary consideration to under section 435A.

However, the court's powers under sections 232 and 233 should not be lightly exercised, especially when a lack of probity or want of good faith is not established.[14] Therefore, even if there is no residual value (whether applying the DRV or CRV), if the circumstances around the share transfer indicate a lack of good faith, this may perhaps amount to unfair prejudice under section 444GA(3). Borrowing this rule, unfair prejudice may exist where, e.g., shares are transferred to creditors where the company's underlying business is strong, or if there exist other feasible projects which do not involve a share transfer. (This is consistent with the Explanatory Memorandum, the former scenario recognised as one where section 444GA may be open to abuse.)

Although the rules regarding oppression may be applied in interpreting unfair prejudice, it is important to note that the former relates to the oppression of a shareholder group vis-à-vis other shareholder groups.

Notes

13 *Morgan v 45 Flers Avenue Pty Ltd* (1987) 5 ACLC 222, cf: *Marks v Roe* (unreported, VSC, Mandie J, 28 May 1996).

14 *Shamsallah Holdings Pty Ltd v CBD Refrigeration & Airconditioning Services Pty ltd* (2001) 19 ACLC 517.

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It may be that, because in an insolvency creditors' interests are given primacy and there is no differentiation *between* shareholders, the oppression tests cannot be applied to the differential treatment of creditors/shareholders without careful consideration.

Residual value may not be the only test in establishing unfair prejudice. Interpretation rules direct that the words of the section be considered before external sources such as the Explanatory Memorandum. Under section 444GA(3), the court may only give leave if the transfer will not unfairly prejudice shareholders' *interests*. Thus, even if residual value is narrowly construed, if the shareholder can establish another interest which is unfairly prejudiced, they could arguably prevent a section 444GA transfer.[15]

There is scope for the broader word 'interests' to encompass a consideration of other rights in the project. An example might be where the shareholder has rights to receive commodities under a preferred offtake or marketing program, the continuation of which require the shareholder to maintain a particular economic interest in the project. In this regard, shareholder interests differ from the company's residual value, depending on the interpretation of residual value. This was expressly rejected in *Windimurra*, the Court holding that in that particular case, the off-take arrangements were not relevant to that party's interests in its capacity as member, citing *Lehman Brothers Holdings Inc v City of Swan* [2010] HCA 11.

Different considerations may arise on differing facts. Arguably, if it can be shown that another viable project is available which does not require the share transfer, the shareholders have an interest in that other project being chosen. This is a transferable measure of wealth creation or confiscation.

Finally, there remains the possibility of the court not finding unfair prejudice even where a residual value exists. The shareholder may have been given another benefit in exchange for their interest, e.g., money or money's worth. It may be difficult to establish unfair prejudice in such scenarios.

Potential defences

Even if the court interprets 'unfair prejudice' narrowly, various defences are available. Members, creditors, ASIC and any other interested person are entitled to oppose a section 444GA(1) application.[16] Other than the section 444GA(3) defence, potential defences include that:

(a) the DOCA (or a provision in it) is oppressive or prejudicial to, or unfairly discriminatory against one or more creditors, or is contrary to the interests of creditors as a whole;[17]

(b) the share transfer is not in the best interests of creditors as a whole;[18] and

(c) the DOCA should be terminated 'for some other reason'.[19] (This gives the court wide discretion,[20] although it was anticipated that the court's powers would be exercised very rarely.)[21]

However, the above defences relate to creditors' interests (which may differ significantly from shareholders' interests), although the Explanatory Memorandum notes that the section 445D defences are open to creditors who are also members subject to a section 444GA application.[22]

Also, 'unfair prejudice' in section 444D is different to that in section 444GA(3) (section 445D referring to unfair prejudice to *creditors*). Therefore, if section 444GA(3) is not established, the court may still strike out the DOCA under section 445D.

Shareholders probably cannot oppose the application on policy grounds alone (i.e. that section 444GA detracts from shareholders' fundamental proprietary rights), as Parliament expressly placed companies' survival above shareholders' proprietary rights by enacting section 444GA.

Conclusion

Although section 444GA has the potential to significantly affect shareholders' rights, little guidance has been provided on its application. However, there is evidently room for 'unfair prejudice' to incorporate the value of the company to shareholders post a restructure

Notes

15 See also *Gambotto v WCF Ltd* (1995) 182 CLR 432, where it was held that finding unfair prejudice where there is no residual value will require a high standard of proof, and the shareholder must point to other interests he or she may have, e.g., valuable rights attaching to those shares which remain notwithstanding the company' dire circumstances.

16 Refer section 444GA(2) of the Corporations Act.

17 Refer section 445D(1)(f) of the Corporations Act.

18 Refer section 437F of the Corporations Act.

19 Refer section 445D(1)(g) of the Corporations Act.

20 *Dean-Willcocks v GSA Formwork* [1999] NSWSC 166 at [17].

21 Refer paragraph 602 of the Explanatory Memorandum to the Corporate Law Reform Bill 1992.

22 Refer to paragraph 7.59 of the Explanatory Memorandum which notes that the parties may be able to challenge the DOCA under section 445D of the Corporations Act.

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or project, protecting shareholders' interests without detracting from the fundamental objective in administrations: the company's survival.

We must now await any further judgments or ASIC guidance confirming the application of this power. The issue may ultimately be a policy debate, balancing shareholders' interests and the perceived benefit of any proposed project to the company. In light of the number of reconstructions in the current economic climate, it may only be a matter of time before relevant guidance is provided.

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