A NEW TOOL IN DISTRESSED PUBLIC COMPANY M&A

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Legal Briefings – By **Andrew Rich** and **Nick Baker**

SUMMARY

- Mirabela is the first ASX listed company to be subject to a section 444GA transaction where shares are compulsorily transferred from shareholders to creditors without the shareholders' consent.
- The key test is whether the shareholders would be unfairly prejudiced. That test is met where it can be demonstrated that the shares have no value.
- Section 444GA assists with the prevention of "greenmailing" where shareholders no longer have an economic interest.
- Section 444GA transactions are a useful tool in distressed M&A and recapitalisations but not appropriate in all circumstances, particularly where significant value would be lost on an administration filing.

BACKGROUND TO THE MIRABELA ADMINISTRATION

A deterioration in the spot price of nickel along with the termination of a significant offtake contract meant that, by the end of 2013, Mirabela was at the mercy of its creditors. These creditors included unsecured noteholders who held US$395m of unsecured debt.

An ad hoc committee of unsecured noteholders proposed a recapitalisation of Mirabela that was completed midway through 2014. A critical component of the recapitalisation was the transfer of approximately 98% of the shares in Mirabela, without shareholder approval, to the unsecured noteholders in exchange for their debt being restructured. The other critical component was the issue of new convertible notes to, primarily, the unsecured noteholders in exchange for cash.

KEY ASPECTS OF THE MIRABELA TRANSACTION

Key aspects of the Mirabela transaction included:

- unsecured noteholders entering into a plan support agreement to “pre-pack” the recapitalisation,
- the transfer of shares through section 444GA of the Corporations Act – although it has previously been used in the context of closely held companies, this was the first time a section 444GA order had been made in the context of an ASX listed company,
- the use of an explanatory memorandum including an independent expert’s report to explain the transaction to Mirabela shareholders (even though they were not being given a vote on the transaction), and
- an ASIC exemption from the 20% rule in Australia’s takeovers rules.

THE PLAN SUPPORT AGREEMENT

A plan support agreement was used to bind approximately 70% of the unsecured noteholders to support the recapitalisation. In any debt for equity transaction certainty is critical and can be jeopardised by trading in the debt. The plan support agreement used in Mirabela adopted accession provisions requiring any noteholder bound by it to ensure that any transferee of its debt agreed to accede to and be bound by the plan support agreement.

TRANSFERRING SHARES UNDER SECTION 444GA

An administrator under a deed of company arrangement may transfer shares without the consent of shareholders if the court grants leave under section 444GA.

The court may only allow the transfer of shares if it is satisfied that the transfer “would not unfairly prejudice the interests of members of the company”.

Section 444GA was inserted into the Corporations Act in 2007. The unfair prejudice test was included as an important safeguard to ensure section 444GA could not be used to advantage creditors where a company was subject to a cash flow squeeze but still had a strong underlying business.

The court considering the Mirabela application heard submissions from aggrieved shareholders. Those submissions, unsurprisingly, argued that there was greater value in the Mirabela equity than that represented by the proposed post transaction 1.8% aggregate stake to be held by the pre-transaction shareholders.

Justice Black, quoting an earlier section 444GA case, stated that:

> *"The notion of unfairness only arises if prejudice is established. If the shares have no value, if the company has no residual value to the members and if the members would be unlikely to receive any distribution in the event of a liquidation, and if liquidation is the only alternative to the transfer proposed, then it is difficult to see how members could in those circumstances suffer any prejudice, let alone prejudice that could be described as unfair."*

In other words, if the equity is completely underwater and no alternative transaction is on the cards, then a very strong argument can be made for a transfer under section 444GA and creditors can avoid the potential of being "greenmailed" by equity holders who no longer have a real economic interest in the company.

USE OF AN EXPLANATORY MEMORANDUM AND INDEPENDENT EXPERT'S REPORT

Mirabela published an explanatory memorandum containing an independent expert's report. The explanatory memorandum contained an overview of the transaction and informed shareholders they could appear at the section 444GA court hearing.

It is important to note that:

- the independent expert was KordaMentha, who were also the administrators of the deed of company arrangement,
- KordaMentha valued Mirabela assuming it was a going concern and using a DCF model. Using a consensus of expert nickel price forecasts, KordaMentha concluded that the enterprise value range for Mirabela ($207m to $279m) was well short of Mirabela's debt of approximately $535m, and
- taking each analyst's nickel price forecast individually, only one of the 19 analysts' forecasts implied an enterprise value above Mirabela's net debt of $527m.

Even when valued on a going concern basis and considering at length scenario analysis and transparency around forecast nickel prices, the independent expert concluded the shares had no value and made it clear to shareholders, ASIC and the court that there was no unfair prejudice to Mirabela shareholders.

APPLICATION OF THE AUSTRALIAN TAKEOVERS RULES

The explanatory memorandum and independent expert's report were also noted by ASIC in the exemption it granted from the 20% rule.

Section 606 of the Corporations Act, broadly, prohibits a person from acquiring voting power of greater than 20% in an ASX listed Australian company or an unlisted Australian company with more than 50 shareholders. There are a number of exceptions to the 20% rule, including an acquisition resulting from a creditors' scheme of arrangement. A transfer of shares under section 444GA is not one of these exceptions.

If the 20% rule would be breached by a recapitalisation proposal, then an exemption from ASIC must be obtained. In the Mirabela transaction an exemption was not necessary for the transfer of shares under section 444GA but was necessary for holders of convertible notes following the recapitalisation to convert their notes in certain circumstances. (Whether or not a particular holder of convertible notes would need an exemption depends on whether other holders have converted their notes, and, if so, to what extent.)

ASIC's underlying concern when considering such an exemption will be whether there is any real economic interest of shareholders to protect (which, in Mirabela's case, the independent expert's report had concluded there was not) and whether the modification will affect the efficient, competitive and informed market for Mirabela shares.

To address these concerns, ASIC made its exemption conditional on, among other things:

- the explanatory memorandum (including the independent expert's report) being prepared and made available to shareholders via ASX,
- a requirement that any association between holders of convertible notes existing on implementation of the transaction be terminated one minute following implementation of the transaction, and
- the fact that the exemption could not be stacked or used cumulatively with acquisitions under the exceptions to the 20% rule.

WHEN IS A SECTION 444GA TRANSACTION APPROPRIATE?

We were pleased to see section 444GA used in respect of a distressed debt restructure involving an ASX listed company and to see ASIC grant exemptions from the 20% rule in relation to such a transaction.

The decision as to which structure to adopt for a distressed M&A transaction or recapitalisation remains one that must be carefully made based on the facts.

In particular, a section 444GA transaction:

- is only available where a company is in administration and will not be appropriate where significant value is lost on putting the company in administration this usually arises through counterparties terminating contracts by enforcing insolvency triggers in those contracts. Australia, unlike the US, does not have an automatic stay that prohibits the exercise of insolvency triggers – these are sometimes called ipso facto clauses. In those cases, a pre-administration filing creditors’ scheme of arrangement may be a better option as a creditors’ scheme can be done outside a formal administration process,

- is available where it can be demonstrated to a court that shares in the company have no residual value,

- does not provide the same flexibility to deal with third party liabilities – such as third party releases - as a creditors’ scheme of arrangement,

- is likely to be more costly than a negotiated outcome,

- will likely require the express consent of secured creditors who are not, by law, required to be bound by a deed of company arrangement, and

- may require an exemption from ASIC from the 20% rule which must be sought on a case-by-case basis (whereas there is already a statutory exemption for acquisitions resulting from a creditors’ scheme of arrangement).

As a result of some of the above points, Mirabela does not herald the end of creditors’ schemes of arrangement (as used in Alinta, Centro and Channel 9) or negotiated recapitalisations (as used in I-MED) but instead provides an additional potential tool in the right circumstances for completing distressed M&A and recapitalisations in the Australian market.

KEY CONTACTS

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

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