On 22 August 2017, the Supreme Court of New South Wales approved the Boart Longyear creditor schemes of arrangement following substantial alterations to the terms of the schemes after clear messaging from the Court that it was unlikely to approve the schemes as originally formulated, on fairness grounds. In this article, we discuss some of the implications of this important judgment, which advisers will need to take into account when devising restructuring plans involving creditors’ schemes of arrangement.

IN BRIEF

- The Court has approved the Boart Longyear creditor schemes of arrangement.
- The schemes of arrangement were significantly amended after the parties undertook a Court-ordered mediation. The Court ordered this mediation after coming to the view that it was unlikely to approve the schemes as originally proposed. This is the first reported occasion on which this has happened in a scheme of arrangement in Australia or the United Kingdom.
- This case raises important issues in respect of the scope of amendments to a scheme which the Court can approve after the classes of creditors have approved it.
• This case illustrates the importance of the Court’s broad fairness discretion in considering whether to approve schemes of arrangement.

• We discuss the matter and the precedent that it sets for future creditors’ schemes.

**BACKGROUND**

On 10 May 2017, as outlined in our [earlier article](#), Justice Black of the Supreme Court of New South Wales granted orders to convene creditor meetings in respect of two schemes of arrangement involving Boart Longyear Limited (BLY). One of BLY’s major creditors, First Pacific Advisors LLC (FPA), had (unsuccessfully) objected to the convening of the meetings on class formation grounds.

FPA appealed the class formation issue to the Court of Appeal. On 26 May 2017, the Court of Appeal unanimously dismissed the appeal, thereby affirming Black J’s orders to convene the two creditor meetings. These decisions surprised many practitioners. We discussed the Court of Appeal’s decision in another [earlier article](#).

Following the approval of the schemes at the creditor meetings by the requisite statutory majorities of the classes that had been formed for the purposes of voting on the schemes, BLY applied to the Supreme Court seeking orders approving the schemes of arrangement. FPA and a shareholder, Snowside Pty Limited (Snowside), objected to the approval of the schemes on a number of grounds.

After 4 days of hearing submissions and evidence, Justice Black ordered that the parties engage in mediation prior to the hearing recommencing. The is the first time this has happened in a scheme of arrangement in either Australia or the United Kingdom. Despite being comfortable with the classes that had been formed for the purposes of considering the schemes, it was clear that his Honour was disposed to decline to approve the schemes on fairness grounds due to the existence of extraneous commercial interests of certain creditors within the classes.

On 9 August 2017, the parties, following mediation, reached a settlement agreement which amended the terms of the schemes and wider restructuring according to a settlement deed between BLY, Centerbridge Partners LP (Centerbridge), Ares Management LP (Ares), Ascribe II Investments LLC (Ascribe) and FPA.

Following this agreement being reached, BLY asked the Supreme Court of New South Wales to approve the schemes of arrangement and to exercise its judicial discretion under s411(6) of the Corporations Act 2001 (Cth) (Corporations Act) to consent to the (substantial) alterations to the schemes of arrangement.

On 22 August 2017, Justice Black approved the BLY creditor schemes of arrangement. On 29 August 2017, Justice Black’s decision was upheld by the New South Wales Court of Appeal.
Justice Black’s thoughtfully reasoned judgment sets an important new precedent that advisers will need to take into account when devising restructuring plans involving creditors’ schemes of arrangement. In this article, we discuss some of the implications of the judgment.

**REFRESHER OF THE RESTRUCTURE**

**ORIGINAL SCHEMES**

Two schemes were proposed: an Unsecured Creditors’ Scheme and a Secured Creditors’ Scheme.

Under the Unsecured Creditors’ Scheme:

- US$196 million of the senior unsecured notes (SUNs) were to be exchanged for 42% of BLY’s post restructuring equity (thus causing BLY’s existing major shareholder, Centerbridge, to be diluted from 48.9% to 3.7%) – this would have resulted in Ares holding 18% of the equity and Ascribe holding 19% of the equity; and
- the remaining US$88 million of SUNs were to be reinstated with an interest rate of 1.5%.

Under the Secured Creditors’ Scheme the holders of the senior secured notes (SSNs), and the holder of the secured Term Loan A (TLA) and secured Term Loan B (TLB), would vote as a single class and (among other things):

- the maturity dates of the TLA, TLB and SSNs were all extended to 31 December 2022 (the expiry dates for the SSNs was 1 October 2018 and for the TLA and TLB was 3 January 2021);
- payment of interest on all facilities was converted to payable in kind (PIK) until December 2018 (the TLA/TLB interest was already PIK which would not change);
- the interest rate on the TLA and TLB was reduced from 12% to 10%, in exchange for the lender under those facilities (Centerbridge) receiving 56% of BLY’s post restructuring equity. Centerbridge would also be granted the right to appoint 5 of the 9 directors to the board of BLY (up from its pre-existing right to appoint 4 directors). The holders of the SSNs would not receive any equity; and
- the holders of those instruments waived their rights in relation to any change of control event occurring as a result of the restructuring (noting that Centerbridge would hold 56% of the shares post-restructuring).
Entities associated with Centerbridge held a significant percentage of the SSN debt and all of the TLA and TLB debt. FPA held 29% of the SSNs, Ares held 18.7% of the SSNs, Ascribe held 23.5% of the SSNs and Centerbridge held 8.5% of the SSNs. The SSNs did not receive any equity under the original schemes.

**FAIRNESS ARGUMENTS**

At the final court hearing, FPA raised a number of objections to the structures of the schemes on fairness grounds. These included that Centerbridge would (among other things):

- increase its shareholding from 3.7% to 56% and that its shares would have option value after the recapitalisation;
- gain the right to appoint 5 of 9 directors;
- gain control of BLY;
- gain priority over SUN holders in respect of the unsecured component of the TLA and TLB debt; and
- suffer a substantially shorter (approximately two year) extension of the maturity date of its debt when compared to that of the SSN holders.

**THE AMENDED SCHEMES**

Under the amended schemes:

- SSN holders will receive a total of 4% of equity in post-recapitalisation BLY;
- the shares issued to Centerbridge will be reduced by 2%, and the shares issued to Ares and Ascribe will be reduced by 1% respectively. The additional shares will be redistributed to the SSN holders;
- if an event of default occurs upon which the SSNs are accelerated, they will be repayable at par plus accrued but unpaid interest, without the payment of premium;
- PIK interest due on the SSNs accrues at 12% from 1 October 2016 instead of at 10% until 31 December 2016, with 12% thereafter; and
- the SSNs may be redeemed according to the prices set out in the new call schedule. These redemption prices specify the prices due if the SSNs are redeemed on an optional
redemption, maturity date, or date of completion of an asset sale offer.

Importantly, the amended schemes had the support of all the voting SSN holders and Centerbridge (as the TLA and TLB holders) (which represented 99.63% of debt under the Senior Creditor Scheme) and all the voting SUN holders (which represented 96.19% of debt under the Unsecured Creditor Scheme) with one exception whose view was unknown. This level of support was very important to the Court’s decision to approve the (amended) schemes (including in relation to its assessment of the fairness of the amended schemes).

**ISSUES AND FINDINGS**

There were two main issues before the Court:

- **section 411(6) issue**: whether the proposed amendments to the schemes were within the scope of s411(6) of the Corporations Act; and
- **fairness discretion**: whether the proposed original and amended schemes met the fairness requirements.

**SECTION 411(6) ISSUE**

Section 411(6) of the Corporations Act simply states:

“*The Court may grant its approval to a compromise or arrangement subject to such alterations or conditions as it thinks just*.”

The issue was whether the proposed alterations to the schemes fell within the scope of the alterations which can be approved under s411(6). Snowside argued that the material and substantial alterations which the settlement agreement achieved went beyond scope of s411(6), which has previously only dealt with changes of a minor or technical nature.

Black J accepted that the fact that the alterations were substantial and were not in the reasonable contemplation of creditors at the meeting is only one relevant consideration, and not a determinant, in the exercise of the discretion under s411(6).

His Honour ultimately found that the proposed changes were within the scope of s411(6) as they:
“provide a proper mechanism to implement a complex compromise or arrangement; substantial costs and resources have plainly been devoted to developing them; the plaintiffs are insolvent or near insolvency and would likely not have the luxury of restarting their restructuring again from the beginning; the plaintiffs and all voting secured creditors and substantially all voting unsecured creditors affected by the alterations support them; and there would be no utility in ordering further creditors’ meetings where it is already clear that an overwhelming majority of the voting secured creditors and voting unsecured creditors support the alterations.”

In coming to this conclusion, his Honour placed considerable weight on the fact that substantially all creditors affected by the changes supported them.

The Court of Appeal agreed with Black J, stating that there was no reason in the text, or context, or purpose of s411(6) to confine the power its operation to alterations or conditions which fell short of being material.

**FAIRNESS DISCRETION**

The Court has an obligation to consider the fairness of a scheme of arrangement, even if all the other statutory requirements, including the requisite creditor approval from each class, have been satisfied. The classic formulation of the fairness requirement was articulated in *Re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213, as follows:

“[the Court] must be satisfied that the proposal was at least so far fair and reasonable, as that an intelligent and honest man, who is a member of that class, and acting alone in respect of his interest as such a member, might approve of it.”

Black J agreed with many of FPA’s fairness arguments on the form of the schemes as originally proposed:

- **the Secured Creditor Scheme and associated arrangements treated Centerbridge, Ares and Ascribe unreasonably favourably in the issue of equity and the grant of director nomination rights to them** - his Honour concluded that Centerbridge, Ares and Ascribe (and other SUN holders and equity holders) do not obtain any significant present financial advantage by the grant of equity, since that equity is presently likely to be worthless or close to worthless, even after the schemes are implemented. However, the equity to be issued to Centerbridge, Ares, Ascribe and other SUN holders and equityholders did, in his Honour’s opinion, have real “option value”, because the worth of that equity would increase, and potentially substantially increase, if the mining environment or the BLY Group’s performance or both improve;

- **waiver of SSN holders’ rights to call in debt on a change of control** - his Honour found this waiver would be disadvantageous to the SSN holders and to the commercial


advantage of Centerbridge since it would remove SSN holders’ ability to require repayment of the SSN debt on the change of legal control arising from the issue of shares to Centerbridge, which will allow Centerbridge to obtain legal control of BLY;

- **conversion of interest payable under the SSNs, at BLY’s option, to PIK interest for a period of two years** - his Honour noted that the present right to receive interest in cash may well be of greater value to an SSN holder than a future right to receive interest at a higher rate, which will be recovered if the BLY Group has capacity to pay it or the SSN holders’ security is sufficient, in a default or insolvency; and

- **the different extent of the change in the maturity date for the debt owed under the SSNs and the TLAs and TLBs** - his Honour noted that this may involve a limited detriment to SSN holders, when BLY likely could not presently repay their debt and they would receive only a portion of that debt in an external insolvency administration.

Black J made it clear throughout his judgment that he would have declined to approve the original schemes on fairness grounds, had they not been amended. His Honour accepted the following submissions from FPA as being relevant to the exercise of the Court’s discretion in deciding whether to approve the originally proposed scheme, including:

- every secured creditor who was not part of the camp of those receiving equity (that is, Centerbridge, Ares and Ascribe) voted against the Secured Creditors’ Scheme; and

- in any event, there was a relatively narrow margin by which the Secured Creditors’ Scheme was approved: 56.82% headcount and 78.49% value.

**COMMENTARY**

The decisions of the New South Wales Supreme Court and Court of Appeal in the Board Longyear restructurings are, perhaps, the most important scheme of arrangement decisions in Australia in almost 40 years. They set important new precedents which are relevant to both creditors’ schemes and members’ schemes. They serve as a timely reminder (if one was needed) that the Court is not a “rubber stamp” and will not approve a scheme of arrangement simply because it has achieved the statutory level of voting support from a class.
The Courts in Australia and the United Kingdom have, since the turn of the century, worked diligently to ensure that class composition issues are ventilated, and to the extent possible, resolved, at the first court hearing so as to avoid the great waste of time and cost that can ensue if the Court declines to approve a scheme on class grounds at the final court hearing. (Historically, a detailed consideration of class (and fairness) issues was deferred until the final court hearing.) We expect that, following the Boart Longyear matter, we may see Courts and practitioners wanting to similarly ventilate, and to the extent possible, resolve any relevant valuation and fairness issues at the first court hearing as well.

Some practitioners may be tempted to query whether, in light of the Boart Longyear decisions, classes really matter anymore in schemes of arrangement. The authors would not go that far: it is still very important to get class composition right in schemes. In a different set of facts, the Court may seek to resolve the matter under the guise of classes rather than, as here, under the guise of the Court’s fairness discretion. In any event, the classes define the group of creditors amongst whom fairness will be assessed.

Whilst not everyone may agree with the approach that the Courts took in relation to classes in the Boart Longyear schemes, Justice Black’s disinclination to approve the schemes in their original form was undoubtedly correct. The envelope had simply been pushed too far in terms of the differential treatment within the relevant groups of creditors.

Importantly, in the context of restructurings, Justice Black held that shares can have ‘real option value’, even if underwater on current valuations, where the value of the equity may substantially increase in the future. He reached this view with the benefit of additional evidence and submissions made at the final court hearing. This evidence was therefore not available to either the Supreme Court or Court of Appeal when considering the class formation issue. Given the Court of Appeal placed significant emphasis in its class formation decision on the fact that the shares would immediately after the restructure ‘likely be of little value’ it would have been interesting to see how the Court of Appeal would have approached the class issue with the benefit of this further analysis on the option value of the shares.

Now that the Boart Longyear matter has concluded, the approach of the Courts throughout the matter can be contextualised as a classic example of:

- the general reluctance of Courts to stop schemes on class grounds, particularly where (as here) splitting a class would result in a particular shareholder (here FPA) being given a veto right; and

- the Courts preferring to rely on the broad fairness discretion at the final court hearing to arrive at what the Courts consider to be the ‘right’ decision (taking into account all the facts and evidence).
That being said, Justice Black is to be commended for his pragmatic, novel approach in this final judgment to the situation that the scheme proponents had found themselves in. If his Honour had simply declined to approve the schemes of arrangement (as he was entitled to do) this would likely have had very serious consequences for the future of Boart Longyear, its creditors, shareholder, employees and the broader communities in which Boart Longyear conducted business. By requiring the parties to mediate and then utilising the scheme amendment mechanics to allow their settlement to be implemented, the Court was able to rescue an otherwise imperilled restructuring.

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