HERBERT SMITH FREEHILLS

COURT PERMITS COMPULSORY ACQUISITION OF SHARES IN TEN NETWORK HOLDINGS

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Legal Briefings – By **George Durbridge**

CBS was recently authorised by the Supreme Court of New South Wales, under section 444GA of the Corporations Act, to compulsorily acquire (for nil consideration) all of the shares in ASX-listed Ten Network Holdings Limited pursuant to a deed of company arrangement since the Court was satisfied that the transfer would not unfairly prejudice the interests of shareholders.

IN BRIEF

- An administrator of a deed of company arrangement (**DOCA**) may transfer the shares in a company with consent of their holders or the leave of the Court (which will only be given where the Court is satisfied that the transfer would not unfairly prejudice the interests of shareholders of the company), pursuant to section 444GA of the Corporations Act.
- This power to transfer shares only arises where a company is insolvent, or is in danger of becoming insolvent – circumstances where the shareholders will have little (or no) equity in the company.
- Where shares have no value, as was the case in Ten Network Holdings, divesting them for no consideration does not constitute prejudice to their holders.

THE SUPREME COURT'S DECISION

The Supreme Court of New South Wales recently allowed the US network CBS to acquire compulsorily (for nil consideration) all of the shares in Ten Network Holdings Limited (**TNHL**), pursuant to a deed of company arrangement (**DOCA**) entered into by TNHL under its voluntary administration. Section 444GA of the Corporations Act empowers the administrator of a DOCA to transfer shares in the company, with the consent of their holders or the leave of the Court. The Court may only give leave if it is satisfied that the transfer would not unfairly prejudice the interests of shareholders of the company.

The context is that Part 5.3A of the Corporations Act allows the directors of a company, if they have decided that it is insolvent or in danger of becoming insolvent, in the sense that it cannot pay its debts as they fall due, to put the company into voluntary administration. Doing so forestalls winding-up proceedings and provides an opportunity to enter into a DOCA, which is in many respects similar to a creditors' scheme of arrangement. The objective of this regime is to enable the business, property and affairs of the company to be administered in a way which maximises the chances of the company (or its business) continuing in existence or, if it cannot continue, brings about a better return for the company's creditors and shareholders than an immediate winding-up.

Accordingly, when section 444GA applies the shareholders will have little (or no) equity in the company, often nil, and a proposal to refinance or reconstruct the company will have been adopted. It is usually used where a deed provides for the shares to be transferred to a person who will provide funds to pay the company's debts, but who requires 100% ownership of the company in return, and the alternative is a liquidation in which creditors will receive less than under the deed, and shareholders will receive nothing at all.

The Court has given leave to transfer shares for no consideration, where it was satisfied that the shares would have no economic value to their holders, if the deed was not put into effect (which usually means the company will be wound up). Where the shares have no value, the court has held that to divest them for no consideration does not constitute prejudice to their holders, let alone unfair prejudice. For this purpose, the court accepts valuation evidence, though not uncritically. The Court is concerned that a deed does not set up an unduly onerous alternative to the transfer of the shares, so as to artificially reduce their value. The loss of an opportunity to exploit the tactical value of the shares, or of a merely speculative hope that the company may restore value to the shares by trading out of its difficulties, however, is not prejudicial for this purpose.

CBS proposed to acquire all of the shares in TNHL for no consideration, on the basis that TNHL had negative equity, and the shares had no economic value. The Court was provided with an independent valuation of the shares in TNHL prepared by KPMG for the purposes of the application. KPMG valued TNHL on several different bases and by several different methods, and took into account a number of contingencies concerning TNHL's business and the market in which it operates. The report was definite that the equity in TNHL had nil value, unless one made a number of assumptions, each of which was quite unrealistic. (KPMG themselves described these assumptions as inappropriate: they only took them into account to satisfy ASIC requirements). Several minority shareholders made submissions to the Court criticising the valuation: the Court heard them out, but was not convinced.

THE USE OF SECTION 444GA

Compulsory acquisition under section 444GA may apply to all of the shares in a company. In this respect, it is quite different from compulsory acquisition under Chapter 6A, which only can affect a fairly small rump of shareholders. The process is different from acquisition under a shareholders' scheme of arrangement, which is approved by a vote of members, because a DOCA is approved by a vote of creditors.

Although the power has only existed for 10 years, it has been used in a dozen or so reported matters, and is now fairly well understood. It requires an application to the court, supported by evidence of the value (or lack of value) of the shares to be acquired. This application may be neither cheap nor easy, but is not very different to an application under section 664F for court approval of compulsory acquisition under the general power in section 664A, over objections. The requirements of such an application are now well understood.

Although acquisition under section 444GA is only available in respect of a company which is insolvent, or likely to become insolvent, shares in such a company may have some value, as the company may not yet be insolvent, or it may have some net assets despite being unable to pay its debts. Whilst the shares have some value, the Court may nonetheless approve their transfer if it is a necessary part of a rescue of the company, but not if the transfer would unfairly prejudice the shareholders. In such a case, the holders must be given some consideration for the transfer: in principle, this could be a cash price, but in practice it has been continuing equity in the company, giving exposure to the fortunes of the company after the deed has been put completely into effect.

There is no exemption from the 20% takeovers threshold in section 606 of the Corporations Act for a transfer under section 444GA of shares in a company to which Chapter 6 applies (a listed company, or one with more than 50 shareholders). In two previous reported matters (being Mirabela Nickel and Nexus Energy) ASIC gave exemptions from the 20% rule to allow transfers for which the court gave leave, and it has intervened to assist the court hearing an application under section 444GA. A similar exemption was granted by ASIC in the case of the TNHL DOCA. Although ASIC has not published policy on the section, in several matters it has required additional or clarified valuation evidence to be provided to it and to the court.

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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