FIRST TAKEOVER BY DEED OF COMPANY ARRANGEMENT – SEVEN GROUP ACQUISITION OF NEXUS ENERGY

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Legal Briefings – By **Rebecca Maslen-Stannage**

SUMMARY

- After Nexus Energy's shareholders voted down a 2 cents per share scheme of arrangement, a Seven Group Holdings subsidiary proposed a deed of company arrangement, under which it would pay an amount to compromise Nexus Energy's debts and acquire all Nexus Energy shares for no consideration.
- This transaction relied on section 444GA of the Corporations Act, which was introduced to address court decisions which cast doubt on the power of administrators to compulsorily transfer shares in an insolvent company to creditors.
- With ASIC relief and a court order, the Seven Group Holdings subsidiary was able to implement an unprecedented, 100% takeover of the listed Nexus Energy while it was in administration through a deed of company arrangement.

BACKGROUND

Nexus Energy was an ASX-listed company which found itself with too much debt in the challenging environment which had developed for oil and gas companies.

With Nexus Energy's debt deadlines looming and extensive asset sale efforts failing to yield any acceptable offers, a Seven Group Holdings subsidiary offered a lifeline: bridging finance which would tide Nexus Energy over until its shareholders could vote on a scheme of arrangement under which the Seven Group Holdings subsidiary would acquire all of the shares in Nexus Energy for two cents per share.

Putting the bridging finance in place on a secured basis within the intercreditor framework necessitated Seven Group acquiring all of Nexus Energy's senior debt and more than two thirds of its unsecured notes. This enabled Seven Group to obtain the necessary consent for the bridging finance to be secured.

The independent expert opined that the scheme of arrangement was fair and reasonable, and Nexus Energy's board recommended it to shareholders. However, Nexus Energy's long-suffering shareholders voted the scheme down, and since Nexus Energy then had no means of paying its debts, its directors appointed administrators.

Seven Group then moved to implement the fallback path (foreshadowed in the scheme booklet) of acquiring Nexus in administration. This involved Seven Group providing further loan funding, this time to Nexus Energy's administrators.

Although Nexus Energy's assets and the company itself had been marketed extensively before the scheme of arrangement proposal, the administrators ran a further marketing process. The only offer was the Seven Group deed of company arrangement, which involved:

- repayment in full of the senior debt – which was by then all owed to a Seven Group Holdings subsidiary, including repayment of the bridge financing and the loan funding to the administrators,
- $30 million in settlement of a litigation claim by Sedco,
- 74.5 cents in the dollar for the noteholders, and
- payment in full of the unsecured creditors through a creditors' trust.

Key conditions to the deed of company arrangement proposal included:

- the court granting leave under section 444GA of the Corporations Act for the share transfer to the Seven Group entity, and

- ASIC relief to overcome the takeovers law restrictions.

SECTION 444GA OF THE CORPORATIONS ACT – CREDITORS CAN BENEFIT FROM A SALE OF THE SHARES

Following the Pasminco administration and court decisions which cast doubt on the power of administrators to sell shares in an insolvent company for the benefit of creditors, section 444GA was introduced to the Corporations Act to make it clear that an administrator can sell or transfer the shares in a company for the benefit of creditors, subject to court approval. The court can grant leave if it is satisfied that the transfer will not unfairly prejudice the interests of members of the company.

The court approval requirement is a 'check and balance' to prevent creditors exploiting a liquidity crunch for a company where the company has positive net asset value. It may 'unfairly prejudice' members of the company for the administrators to sell the company’s shares where the value of the company’s assets outweighs its debts.

ASIC RELIEF

Section 444GA of the Corporations Act had previously been relied on to acquire tightly-held companies. But for a takeovers-regulated company like the ASX-listed Nexus Energy, there is the additional complication of needing ASIC relief. Since there is no automatic exemption from the takeovers rules for an acquisition under deed of company arrangement (**DOCA**), ASIC also needs to be persuaded that it is appropriate to grant relief.

There had been one previous 'loan to own' restructure of an ASX-listed, takeovers-regulated company using section 444GA. Mirabela Nickel was granted relief by ASIC for its unsecured noteholders to be transferred, between them, almost all Mirabela Nickel’s issued shares in exchange for relinquishing debt. The original shareholders retained a small holding (1.8% between them). However, that ASIC relief was conditional on the former noteholders severing the association between them as soon as the shares were delivered to them. Therefore, Mirabela Nickel would continue to be reasonably widely held after the transaction, with its original shareholders also retaining a small interest.

Seven Group sought to take use of section 444GA to a new level, seeking a court order and ASIC relief to permit it to acquire 100% of the shares in the ASX-listed, takeovers-regulated Nexus Energy.

Unlike the unopposed Mirabela Nickel section 444GA application, the Seven Group / Nexus Energy proposal was vigorously contested by a shareholder group – which lobbied ASIC and fought the transfer in a 5 day court hearing. However, ultimately both ASIC and the Supreme Court of New South Wales granted the necessary relief and court order respectively for the transfer of 100% of the shares in Nexus Energy to Seven Group. The shareholder defendants have since informed the Court that they will not appeal the decision.

WHY WERE THE COURT AND ASIC WILLING TO GRANT THE RELIEF?

Why? Simple economics - and the policy of both the administration provisions of the Corporations Act and corporate law more generally in weighing up the interests of shareholders versus creditors once a company has become insolvent.

An underlying principle of corporate law is that, once a company is insolvent (particularly if on a balance sheet basis rather than just a liquidity basis), the interests of creditors prevail over those of shareholders. Ultimately in relation to Nexus Energy both ASIC and the Court relied on independent expert evidence obtained by the administrators, which indicated that Nexus Energy was insolvent on a balance sheet basis. The shareholders' efforts to assert in court that the shares had some value (including an expert theory requiring some mental gymnastics, that bidders might pay more for an asset which is subject to a pre-emptive right or similar right in insolvency than was ever offered when the company was solvent) were rejected.

Nexus Energy shareholders would have received the same return – nil – whether the DOCA was implemented or whether Nexus Energy went into liquidation. It was the creditors who would have suffered if Nexus Energy went into liquidation, with the effect that all creditors would have been substantially worse off than if the DOCA was implemented. What ASIC and the Court did was prevent those shareholders from standing in the way of creditors maximising their return and Nexus Energy's employees keeping their jobs, when the shareholders would not get a return on any scenario (having voted down the solvent scheme of arrangement which would have delivered them two cents per share).

Nexus Energy's subsidiaries were able to be kept out of administration – funded by SGH through funding to the administrators – while the DOCA proposal was implemented, avoiding the value destruction which could have occurred if the entire group went into administration.

The fact that Nexus Energy's other external creditors supported the DOCA rather than a liquidation was a powerful indication to ASIC and the Court of the creditors' assessment of value. The Court also had regard to words of wisdom from a past compulsory acquisition decision that the marketplace – what someone will actually pay for an asset and market comparables – is a better indication of value than an abstract theoretical valuation based on assumptions (like gas prices more than a decade into the future) - when considering whether shares have positive value and therefore whether shareholders are unfairly prejudiced.

COMMENTS

One issue which the administrators and Seven Group had to overcome was apparent denial by the shareholders of what had become quite clear following extended efforts by Nexus Energy over a period of time before administration and by the administrators subsequently – that no one was willing to pay enough for Nexus Energy or its assets to repay its debt in full. In that context, we query whether it is the correct approach to require (as ASIC did for the separate purpose of considering whether to grant takeovers relief) a valuation of the company on a 'going concern' basis on the theoretical assumption that funding was available, in addition to the valuation on a liquidation basis. In the light of the Court’s conclusion that the theoretical going concern valuation is not relevant to the section 444GA determination, such a theoretical valuation may confuse shareholders or cause them to hold out false hopes. When a company is insolvent, we suggest that a liquidation valuation is helpful but that a hypothetical, funded going concern valuation is not.

Finally, comments in the Nexus Energy decision should discourage any would-be greenmailers who may seek to oppose future applications for leave under section 444GA. Justice Black, consistent with earlier judges who have considered section 444GA, rejected the argument that shareholders are unfairly prejudiced because an order for leave to transfer the shares will deprive them of 'strategic value' or 'loss of an opportunity to negotiate' with a bidder to get some payment for their shares.

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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LEGAL NOTICE
