HERBERT SMITH FREEHILLS

HEDGE FUNDS WISE UP TO TAKEOVERS PANEL AS THE IDEAL FORUM FOR DISTRESSED COMPANY DISPUTES

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

SUMMARY

- Recent enthusiasm by hedge funds for airing their grievances before the Takeovers Panel shows that these investors have 'wised up' to the advantages of the Takeovers Panel for exerting pressure in distressed company transactions.
- We expect that appealing aspects of the Takeovers Panel process will see it become a more frequently used weapon in the hedge fund's armoury going forward.

HEDGE FUNDS – A FRESH LOOK AT TAKEOVERS TECHNOLOGY

Once distressed debt funds started focusing on the Australian takeovers rules in the course of implementing the wave of 'loan to own' transactions that started with Alinta and Centro, it was only a matter of time before they thought of creative ways to use Australian takeovers technology in distressed company situations.

For example, in the Centro transaction, Marathon Asset Management used ASIC's 'Truth in Takeovers' policy to apply pressure to Centro Retail. Marathon, a substantial security holder in Centro Retail, made a public announcement to the effect that it intended to vote against the restructure in the absence of improvements in the terms for Centro Retail's unitholders.

Marathon was rewarded when Centro Retail then negotiated improved terms for the benefit of its unitholders, and the restructure votes were subsequently passed.

HEDGE FUNDS STEP INTO THE TAKEOVERS PANEL ARENA

The next step by hedge funds into the Takeovers Panel arena was a logical one. Compared with the Australian courts, there are major advantages for a distressed debt fund wishing to challenge a company’s conduct and apply pressure in the process. The Takeovers Panel does not have the formalities of a court such as pleadings and formal procedures. This makes it a much cheaper forum to have a stoush in than a court.

Hedge funds from other jurisdictions with very different rules are taken aback to find that the loser in an Australian court generally has to pay the winner’s costs. On the other hand, the Takeovers Panel generally makes no costs orders.

A hedge fund asking the Takeovers Panel to stop a company taking some action does not have to pay the ‘undertaking as to damages’ which would be required by a court as the price of an injunction. This allows the hedge fund to avoid the risk of having to compensate the company for any loss and damage suffered.

The immediate media attention around a Takeovers Panel application (despite the Takeovers Panel’s own restrictions on the parties publicising the proceedings) increases the pressure by putting issues into the spotlight. This can help to generate momentum and publicity which may otherwise have been difficult.

And the Takeovers Panel is fast – with decisions typically taking days or weeks rather than months. Disputes are not drawn out – even if the outcome is unfavourable, the hedge fund can then move quickly onto the next stage or tactic.

The Billabong proceedings were a celebrated case of distressed debt funds using the Takeovers Panel. There the proceedings were brought by a consortium comprising distressed debt investors Oaktree and Centerbridge on behalf of various funds.

Those investors, who were at the time in discussions with Billabong regarding a refinancing proposal, challenged aspects of the transaction agreed between Billabong and a consortium led by Altamont. The applicants submitted that the convertible note increased coupon (which applied until shareholder approval for aspects of the transaction were obtained) and the termination fee amounted to lock-up devices which were anti-competitive and coercive. The investors also complained of insufficient disclosure of the terms of the exclusivity arrangements and the details of the circumstances in which the termination fee may be payable.

Altamont and Billabong renegotiated the objectionable aspects of their agreement under the threat of a declaration of unacceptable circumstances. Less than a month after the conclusion of those successful Takeovers Panel proceedings, Oaktree and Centerbridge successfully obtained Billabong's endorsement of their own alternative long term financing and recapitalisation proposal.

More recently, Coastal Capital, a 19.16% holder of hybrid securities in the PaperlinX SPS Trust, complained to the Takeovers Panel about aspects of PaperlinX's off-market bid for the SPS Trust. Among other things, Coastal Capital argued that hybrid holders may be coerced into accepting the bid because of the risk that their rights would be substantially diminished by PaperlinX carrying out its stated intentions and because there is an imbalance of rights between PaperlinX and the hybrid holders.

While the Takeovers Panel declined to conduct proceedings in that case, we doubt this will discourage other potential applicants.

MORE DISTRESSED COMPANY DISPUTES IN THE TAKEOVERS PANEL

There is so little downside for a hedge fund in bringing a Takeovers Panel application in a distressed context, that we expect disputes relating to companies in varying degrees of distress to be an increasingly regular aspect of the Takeovers Panel landscape going forward.

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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