

# PULSE RESTORED TO SCHEME AFTER SIDE DEAL AND VOTING COMMITMENT

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Legal Briefings - By **Andrew Rich** and **Joshua Santilli**

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In an important recent decision, the Supreme Court of NSW has concluded that a target shareholder that gave a bidder an undertaking to vote in favour of a scheme of arrangement, in circumstances where the bidder acquired a number of assets from persons connected with the shareholder, was not required to vote in a separate class. This is the first occasion on which an Australian court has considered the class implications of a voting commitment linked to a side deal.

## IN BRIEF

- There is often a question as to whether commitments given to bidders by target shareholders to vote in favour of a scheme of arrangement, as well as side deals conferring collateral benefits on particular shareholders, will create separate shareholder classes for voting purposes or require certain shareholder votes to be discounted or disregarded entirely.
- Whilst these issues have been separately considered in previous cases, in a recent decision an Australian court has, for the first time, considered the class implications of a voting commitment that was linked to a side deal.
- Ultimately, the Court approved the scheme in question and concluded that neither the voting commitment nor the side deal created separate classes for voting purposes.
- In reaching this result, the Court noted that a supplementary scheme booklet had been

sent to target shareholders disclosing details of the side deal and voting commitment and an independent expert had concluded the side deal did not result in a “net benefit” to the shareholder in question.

## BACKGROUND

Health Care Australia Pty Ltd (**Health Care**) proposed to acquire all the shares in Pulse Health Ltd (**Pulse**) by way of an all cash scheme of arrangement.

After the scheme booklet had been published but before the scheme meeting was held, Health Care entered into an agreement to acquire certain hospital businesses of Evolution Healthcare Partners Pty Ltd (**Evolution**) for a purchase price of \$53 million – Health Care also entered into certain long-term lease arrangements with Evolution with respect to the properties from which the hospitals operated. These collateral transactions (together, the **Side Deal**) were not conditional on the approval of the scheme of arrangement.

Although Evolution was not a shareholder in Pulse, there were either associations, or at least common linkages, between Evolution and Sante Capital Investments Nominees Pty Ltd (**Sante Capital**) which was a 15.79% shareholder in Pulse. Pulse considered that Evolution and Sante Capital were associates, although that proposition was not accepted by Evolution or Sante Capital. In any event, the Court did not need to resolve this point of contention and essentially took the same approach as it would have taken if they were, in fact, associates.

At the same time as the Side Deal was entered into, Sante Capital gave an undertaking to Health Care to vote in favour of the scheme of arrangement and not to dispose of its shares (the **Voting Commitment**). The Voting Commitment would cease to apply if (among other things):

- the Pulse board recommended a superior proposal or withdrew its recommendation in respect of the scheme; or
- the independent expert changed or withdrew its opinion and concluded that the scheme was not in the best interest of Pulse shareholders.

These arrangements gave rise to an important question: namely, did either the Side Deal or the Voting Commitment require the creation of separate classes for voting purposes?

Whilst Australian courts have previously considered the class implications of:

- voting commitments in schemes of arrangement (for example, see the *EvoGenix*, *People Telecom*, *Mosaic Oil* and *Straits Resources* schemes); and
- side deals / collateral benefits in schemes of arrangement (for example, see the *Sylvastate*, *Aston Resources*, *Texon Petroleum* and *David Jones* schemes).

The Pulse scheme was the first occasion on which a Court has had to consider the class implications of the dual impact of a voting commitment combined with a side deal / collateral benefit.

## THE SIDE DEAL

In light of the collateral benefit (ie the Side Deal) given, albeit indirectly, by the bidder to a target shareholder in this case, a supplementary scheme booklet was prepared which:

- disclosed details of the Side Deal (and the Voting Commitment); and
- attached an independent expert's report, containing an opinion that the Side Deal did not confer a "net benefit" upon Evolution or Sante Capital. For the purposes of this assessment, the independent expert assumed that any "net benefit"<sup>1</sup> received by Evolution would also be received by Sante Capital, given the common linkages between the two entities, but accepted that Sante Capital was not a party to the Side Deal.

The Court concluded that, in light of the fact that no "net benefit" was being conferred on Evolution or Sante Capital, the Side Deal did not create a difference in the rights of Sante Capital such that it was necessary for Sante Capital to vote in a separate class.

## THE VOTING COMMITMENT

A question also arose as to whether, in light of the Voting Commitment, it was appropriate for Sante Capital to vote in the same class as the other shareholders. In this regard, the Court concluded that Sante Capital could still vote in the same class as the other shareholders.

The Court noted that separate class meetings were not required in this case because the rights and entitlements of Sante Capital and other shareholders, viewed in the totality of the scheme's context, were not so dissimilar as to make it impossible for them to consult together with a view to their common interest (being the accepted test for determining whether shareholders should constitute a separate class).

## TAGGING

Whilst the Court was content that neither the Side Deal nor the Voting Commitment (nor the co-existence of both of them) required the creation of a separate class, the Court did consider it appropriate for Sante Capital's votes to be "tagged" so that the Court could be informed, at the final court hearing, whether or not Sante Capital's votes made a difference to the outcome of the vote. The tagging meant that, if, at the final court hearing, an objector was able to convince the Court that, despite the independent expert's view, Sante Capital was in fact receiving a "net benefit", the Court could consider the impact of that net benefit.

If the votes did make such a difference, the Court would have been entitled to:

- take this fact into account as part of its fairness discretion; and
- if it considered it appropriate to do so, discount or completely disregard the votes on the grounds of an extraneous commercial interest (thereby potentially causing the scheme to fail).

However, as is often the case when votes are "tagged", in the case of the Pulse scheme, Sante Capital's votes were not decisive and the scheme would still have achieved the requisite level of shareholder approval even if the votes were taken out of the voting pool altogether.

## COMMENTARY

So where does this leave the current state of play on collateral benefits and voting commitments in schemes of arrangement? Although each case will, as always, turn on its own facts and circumstances, the general position is set out below.

As to collateral benefits, generally speaking:

- if the collateral benefit does not confer a "net benefit" on a shareholder, the benefit should neither be class creating nor require the shareholder's votes to be discounted or disregarded; and
- if the collateral benefit does confer a "net benefit" on a shareholder, the benefit may either be class creating or, more likely (particularly if the benefit is coming from the bidder), require the shareholder's votes to be discounted or disregarded.

As to voting commitments, these will generally not be class creating, however:

- if the shareholder has committed to vote in favour of the scheme in the absence of a superior proposal, the Court is unlikely to discount or disregard the votes of that shareholder; and
- if the shareholder has committed to vote in favour of the scheme irrespective of whether a superior proposal emerges, the Court may consider whether it is appropriate to discount or disregard the votes of that shareholder.

## ENDNOTES

1. The Takeovers Panel has explained that, in considering whether a collateral benefit constitutes a “net benefit” it is necessary to, firstly, compare any advantage that is received by the particular target shareholder under the relevant side deal with the bidder against what all other target shareholders are receiving in connection with the takeover or scheme, rather than analysing the benefit in isolation. Secondly, the advantage received by the shareholder must be compared to what the shareholder has given up. It is only if the advantages of the side deal outweigh the detriments suffered in connection with the side deal that there can be said to be a “net benefit”.

## 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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