THE POTENTIAL FOR RECAPITALISATION PROPOSALS TO BE CHALLENGED IN THE TAKEOVERS PANEL – THE FAILED MCALEESE DEAL

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Legal Briefings – By **Nick Baker**

After a fraught period as an ASX listed company, including the near collapse of iron ore miner and major customer, Atlas Iron, the transport company McAleese Limited has entered voluntary administration.

SUMMARY

1. Recapitalisations of distressed ASX listed companies are capable of being challenged by disgruntled shareholders through the Takeovers Panel.

2. Havenfresh (a disgruntled 14% shareholder) launched its Takeovers Panel challenge too early, before any of the required shareholder approvals had been sought and prior to an independent expert's report and explanatory memorandum being sent to McAleese shareholders.

3. In highly distressed situations, particularly where the value of the company's debt exceeds the value of its equity, it is difficult to see how and why the Takeovers Panel would intervene and take a view on what value remains for shareholders depending on who the relevant lender is.

In the lead up to this point, a proposal by McAleese's existing lenders and a consortium led by debt fund SC Lowy to reduce McAleese's senior debt and to recapitalise the company was challenged in the Takeovers Panel by Havenfresh Pty Ltd (who held approximately 14% of McAleese's ordinary shares).

THE RECAPITALISATION PROPOSAL

The SC Lowy backed recapitalisation proposal involved the SC Lowy consortium buying the existing McAleese senior debt, McAleese entering into a new senior debt facility with the SC Lowy consortium (which would fund the repayment of some of the existing senior debt with the balance to be compromised), the issue of zero strike price options to the SC Lowy consortium (converting into approximately 35% of the ordinary shares in McAleese) and certain fees payable to the SC Lowy consortium.

The recapitalisation proposal also involved a renounceable, pro rata entitlement offer for convertible notes (converting into approximately 60% of the ordinary shares in McAleese). The convertible notes offer was to be underwritten by an entity associated with Mark Rowsthorn, the CEO of McAleese and one-fifth sub-underwritten by a third party.

While the SC Lowy consortium's recapitalisation proposal left little on the table for McAleese's ordinary shareholders (they did have the opportunity to take up convertible notes and participate in any future upside), this was hardly surprising given the extensive distress the company was facing. Further, it was the only proposal standing after an extensive search for an alternative transaction where over 65 parties were approached.

The recapitalisation proposal was signed up by McAleese as a package and subject to shareholder approval.

HAVENFRESH'S TAKEOVERS PANEL CHALLENGE

Havenfresh took its dissatisfaction with the recapitalisation proposal to the Takeovers Panel arguing that:

- the recapitalisation proposal, in particular the timing of the senior debt acquisition (which was to occur prior to McAleese shareholders voting on the recapitalisation), resulted in unacceptable coercive pressure being applied to existing shareholders to approve the issue of options to the SC Lowy consortium;
- the entitlement offer and underwriting arrangements had been structured to deliver control of McAleese to entities associated with Mark Rowsthorn without shareholder approval; and
- the SC Lowy consortium and entities associated with Mark Rowsthorn were associates.

Perhaps most interestingly, Havenfresh made its application to the Takeovers Panel before the recapitalisation proposal was explained in an explanatory memorandum to McAleese shareholders and before an independent expert's report was provided.

THE TAKEOVERS PANEL REFUSED HAVENFRESH'S APPLICATION ON ALL GROUNDS.

It knocked back the assertion that the recapitalisation proposal was coercive, noting that McAleese was significantly and undoubtedly distressed, that the timing of the senior debt acquisition was "unlikely to change the position of shareholders" and that it was "part of a legitimate commercial transaction" – in this case, the sale of debt from existing lenders to an incoming lender.

These are all reasonable grounds we agree with. If the Takeovers Panel were to intervene on the timing of debt trades, it would be making a call that shareholders' perception of how one lender or another would act would influence the shareholders' vote. It is difficult to see how or why, in the circumstances of a highly distressed company (particularly where the value of the company's debt exceeds the value of its equity), the Takeovers Panel would take a view as to what value remains for shareholders depending on who the relevant lender is, particularly where, such as in this case, there is no legitimate alternative transaction on the table. Further, how can the Takeovers Panel reasonably be expected to intervene in a debt trade (as opposed to a subsequent debt-for-equity proposal)?

In relation to the entitlement offer, Havenfresh jumped the gun. The entitlement offer had not been launched. Subsequent to the Takeovers Panel case, McAleese's notice of meeting sought the necessary shareholder approval. Again, it is difficult to see what the Takeovers Panel can do when a complaint is made too early other than simply ask whether the parties intend to follow the law.

Finally, the Takeovers Panel also thought the association issue was raised too early and, without deciding whether Havenfresh had made out an association case, thought that any association issues could be raised if and when relevant.

COMMENTARY

The McAleese situation highlights again the highly charged dynamics of a debt-to-equity deal. In these circumstances, there are almost inevitably disappointed shareholders and questions about if and how value can be preserved for shareholders.

In McAleese, the Takeovers Panel has asked the same questions asked by it in Billabong and Pasminco. What is the level of distress facing the company? Do shareholders have an opportunity to act? Should the Takeovers Panel intervene and how?

As the subsequent voluntary administration and lack of an alternative, more shareholder friendly, deal show; McAleese was not a situation where the Takeovers Panel could reasonably intervene and sensibly protect shareholders.

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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