Debt Restructuring
In uncertain times

2020

Contents

Disclaimer:
This document provides a general overview and is not a substitute for obtaining legal advice.

Introduction

In the current circumstances, businesses are facing unprecedented financial pressure. This will require many to reduce their liabilities to enable their business to continue as a going concern.

One common method to achieve this is a debt restructure, converting debt for equity. This is a short overview of common structures to undertake a debt restructure and an outline of the key steps required to undertake this process and the pros and cons. It is not meant to be a technical analysis of the legal issues involved. Rather, it is an overview of some of the main restructuring approaches which can be adopted to right size the balance sheet to enable a company to stay solvent or become solvent once again.

Ron Forster
Partner

"We discuss three of the main restructuring approaches which can be adopted to right size the balance sheet to enable a company to stay solvent or become solvent once again."

Introduction

Implications of COVID-19

The moratorium on directors' personal liability for debts incurred when a company is insolvent for six months (Directors' Moratorium) may provide a current window for companies to undertake a debt restructuring before the moratorium expires. Directors must still comply with general law and statutory duties, including to take into account the interests of creditors if the company is in financial distress.

Usually the sooner the board commences formulating a plan to deal with the solvency issues, the more potential options will be available to the company to resolve these issues. This is especially the case in the current circumstances as the restructuring often takes more time to implement than anticipated and the Directors' Moratorium period will expire all too quickly. The current expiry date of 25 September 2020 is also very close to the final deadline date of 30 September 2020 for ASX listed companies with financial years ending 30 June to issue their final audited accounts.

The restructure of the balance sheet would also be in conjunction with other steps such as reducing costs where possible, potentially receiving government assistance under various announced COVID-19 programmes, arrangements relating to the workforce, considering rent relief and seeking waivers from lender covenants, extensions to maturity dates and negotiating delays to interest payments.

A debt restructure which is formulated, and ideally a restructure agreement entered into, during the Directors' Moratorium period may be sufficient to enable the directors to rely on the safe harbour defence against personal liability of directors for debts incurred when a company is insolvent (Safe Harbour Defence). This would enable the company to continue to trade, and the restructuring plan to be implemented, after the expiry of the Directors' Moratorium period.

For more details on the Directors' Moratorium and the Safe Harbour Defence see: COVID-19 response - six month suspension of insolvency laws

Introduction

This note outlines three broad approaches to debt restructuring and sets out the major steps required for each.

Debt restructuring agreed between the parties

Ideally it will be possible for a company in financial difficulties to reach agreement with key lenders and other key stakeholders such as shareholders and other lenders, if required, to the terms of a restructuring. Then they can implement the restructuring as agreed.

Under this approach, the company would not go into external administration but would continue to trade through the restructuring process.

If it is not possible for the company to continue to trade where, for example, insolvency is inevitable or it is not possible to reach agreement with the relevant lenders, then one of the other two structures would need to be considered.

Solvent creditors scheme

This is a structure where a company can continue to trade and restructure its debt through a creditors scheme of arrangement where sufficient creditors agree to the terms of the restructure at a meeting of creditors. Creditors who do not agree to the scheme are still bound by the scheme if it is approved by the Court and implemented.

This approach is often used where a company has different classes of debt outstanding such as loan notes. The holders of the loan notes receive shares in the company to extinguish or reduce the outstanding debt.

External administration - deed of company arrangement

If it is not possible for a company to continue to trade because the company is insolvent (ie. unable to pay its debts as and when they fall due) and the Directors' Moratorium has expired (and the Safe Harbour Defence is not available), then an external administrator will need to be appointed.

When a company is under administration, it can undertake a debt restructuring through a deed of company arrangement (DOCA). In some cases, the use of a DOCA may be a preferable approach, even though it involves appointing an external administrator. This is because an administrator is able to terminate onerous contracts following their appointment, such as real property leases. It is expected this may be the preferable approach in the retail sector where a business has a number of premises under long term lease which are now no longer viable. These leases could be terminated by the administrator and a smaller but viable business could emerge out of administration following the implementation of a DOCA. A DOCA can also provide an opportunity for the administrator to develop a more permanent restructure of the company, including by a creditors scheme of arrangement.

Structure 1
Consensual restructure agreed with lender(s)

This is the most straight forward approach where a lender, or a group of lenders, agrees to take an issue of shares in exchange for the repayment of the debt. Instead of paying a cash subscription amount for the issue of the shares, the issue price for the shares is satisfied by the repayment of the debt.

The two key issues here are:

- Whether the lender is willing to take equity instead of cash as a debt repayment; and
- At what price will the shares be issued.

While this structure is relatively simple to implement, it is necessary to consider the need for FIRB approval and, for public companies, shareholder approval requirements under the ASX Listing Rules.

For unlisted companies, there may be additional requirements under the company's constitution and any shareholders agreement binding shareholders.

Unfortunately for companies facing financial difficulty, the closer the company is to insolvency when it undertakes the share issue, the greater the discount to the current market share price usually required by investors/lenders. The earlier the company moves to address the solvency issues, usually, the better the outcome.

Structure 1
Consensual restructure agreed with lender(s)

Willingness of lenders to accept equity

The willingness of a lender, or group of lenders, to negotiate a debt for equity swap will partially be influenced by the value of the company's assets as a whole compared to the company's total debts and other liabilities as a whole.

This in turn will be broken down to the value of the assets that secured creditors have security over and, for unsecured creditors, what will be the likely return in the event of liquidation. Unsecured lenders, or secured lenders with security over assets which are less than the amount of the loan, may be willing to agree to a debt for equity swap because if they don't, the alternative may be external administration, and possibly liquidation, where those creditors would receive less of a pay out, or no pay out at all. Sometimes it is the recognition that a company may actually have no choice but to go into external administration which provides the catalyst for creditors or a group of creditors to agree to restructure their debt.

Typically, major banks have been reluctant to accept equity as full or a partial debt repayment. More commonly, major shareholders which have lent funds to the company may consider converting some or all their debt for equity. Equity conversion of shareholder loans may also be a condition imposed by major lender(s) agreeing to amend loan terms such as deferring interest payments (or converting debt for equity) or granting waivers to loan covenants and/or extensions to maturity.

Alternatively, a new lender paying out the existing lender(s) which, for example, would not grant waivers to upcoming events of default (such as not being able to pay interest payments when due) or grant extensions to the loan repayment date, may impose as a condition to the new funding that some or all the existing loans are converted to equity.

Loan notes

If a company has loan notes on issue, it may be possible to restructure the terms of the loan notes by agreement from each noteholder to swap the loan notes for equity. Alternatively, the loan note trust deed often provides that the terms of the loan notes can be varied, for example, to defer interest and extend the maturity dates sometimes with approval at a meeting of noteholders holding a 75% majority of the face value of the notes.

While it may be possible to defer interest and extend the maturity date under this process, it is not possible to compel the holder of loan notes to accept shares as repayment of the loan without the agreement of the relevant note holder. However, it is possible to introduce a right to convert the loan to equity at the option of the noteholder or make an offer to the noteholders to swap the notes for equity.

Structure 1
Consensual restructure agreed with lender(s)

Assignment of debts

A lender may be willing to assign its debt to third parties for the face value of the debt or less. Parties can acquire the debt as a mechanism to try and force a 'loan to own' transaction by purchasing the debt and then withholding agreement to any waivers or debt extensions unless the debt is either paid in full, which may not be possible, or alternatively agree to accept equity in exchange for full or partial repayment of the debt.

If the debt is secured debt and the company is not in a position to repay it or refinance it, the acquirer of the debt can put itself in a strong position to either take control of the secured assets or take control of the company. Often lenders are free to assign their loans and sometimes a company may not know this has occurred until after the assignment takes place. Under some syndicated loan agreements, there are restrictions to assigning the loan to third parties without first offering the assignment to existing members of the syndicate or obtaining the consent of syndicate members.

Pros

- Simple and fast to implement
- No need for creditors' schemes or administration, and no court proceedings necessary, reducing restructuring costs and timing
- Minimum disruption to business and adverse publicity
- Prevents loss of value that can result from formal insolvency procedure
- Post-restructure profits will benefit shareholders and creditors

Cons

- Need to check compliance with applicable approval thresholds under finance and security documents, the company's constitution and any shareholders agreement
- Agreement would usually be required from each lender so this approach will not be available unless all the necessary lenders agree. It only binds the creditors that agree and cannot bind other creditors or other parties

Structure 1
Consensual restructure agreed with lender(s)

Steps to undertake consensual debt for equity swap

Key steps to undertake a consensual debt for equity swap are set out below.

Reach agreement with the lender(s)

Negotiate a restructuring agreement between the lender(s) and the company as to the terms of the restructuring. That is, the amount of debt to be repaid by the issue of shares, the issue price of the shares and any pre-conditions to be satisfied (such as shareholder and / or any necessary FIRB approval).

Cash does not actually need to be paid on the subscription of the shares but the subscription amount for the shares can be credited by the amount the debt is repaid.

If not all the debt between the lender and the company is being capitalised, the agreement needs to address amendments to the terms of the remaining debt arrangements.

Certain taxation issues will need to be addressed in structuring the debt for equity swap but the tax issues should be simplified if the shares are issued at a fair value. For private companies, a valuation of the shares may be required, and if so, the mechanics for arranging this can be included in the restructuring agreement.

FIRB approval

Whether or not FIRB approval is required may be a critical timing issue given delays expected from FIRB over the next six months. FIRB is estimating approvals will be delayed and may take up to three to six months.

Given a significant amount of debt funding for Australian companies comes from overseas, it will be important to determine if FIRB approval will be required. Our FIRB team is in regular contact with FIRB and advises that in appropriate cases expedited approval may be possible.

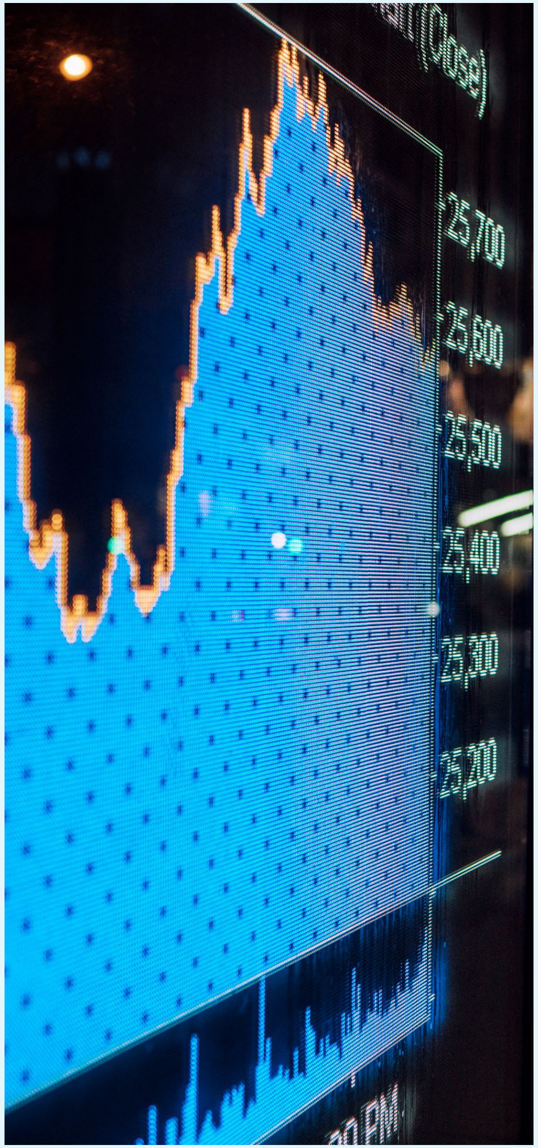
Amendments to FIRB requirements

Recent amendments to the Foreign Acquisition and Takeovers Act 1975 (FATA) have altered the approval requirements for foreign parties acquiring assets in Australia.

In short, approval thresholds have reduced to zero which means FATA applies to all acquisitions. If under FATA a foreign person is not classified as a foreign government investor (FGI), then it may be possible for the non FGI to acquire up to 20% of the company's shares without FIRB approval. There are certain exceptions for particular industries and particular sectors, such as media or entities with significant land holdings (including leases). This also depends if the non FGI has veto rights over board decisions. This issue needs to be carefully considered if the investor remains a lender to the company and, as a part of taking equity, will have a nominee on the board.

FIRB approval may also be required for a foreign lender to take security over assets. There is an exception for money lenders operating in the ordinary course, however, there are exceptions to this.

For more detail of those amendments, see: [COVID-19: Temporary changes to foreign investment in Australia](#).



Structure 1
Consensual restructure agreed with lender(s)

Disclosure issues

With any issue of securities by a company, consideration must be given to the fundraising provisions in Chapter 6D of the Corporations Act 2001 (Act). An offer of securities for issue will require disclosure (eg. in the form of a prospectus) unless a specific exemption applies.

There are a number of exceptions that may apply to enable a debt for equity swap without regulated disclosure. Among other exceptions, a disclosure document is not required when shares are offered to:

- Sophisticated and professional investors;
- A person as a personal offer, on the basis that offers do not result in more than 20 people being issued with securities in any 12 month period and the amount raised does not exceed $2 million in the 12 month period; or
- Any or all the company's creditors under creditors scheme of arrangement (see further Structure 2) or a deed of company arrangement (see further Structure 3).

Additional steps for listed public companies

Approvals under ASX listing rules - Placement Capacity Exceeded / Lender is a Substantial Shareholder

An ASX listed company can issue up to 25% of its capital (uplifted from 15% to a maximum of 25% under the recent temporary amendments to ASX Listing Rule 7.1 provided a follow on capital raising is offered to existing shareholders at the same price such as through a share purchase plan) without shareholder approval under Listing Rule 7.1.

Shareholder approval under ASX Listing Rule 10.11 is required if the lender is already (or was in the previous six months) a shareholder holding:

a) 10% or more of the company's issued shares and has nominated a director to the board (pursuant to a right/expectation to do so); or

b) 30% or more of the company's issued shares.

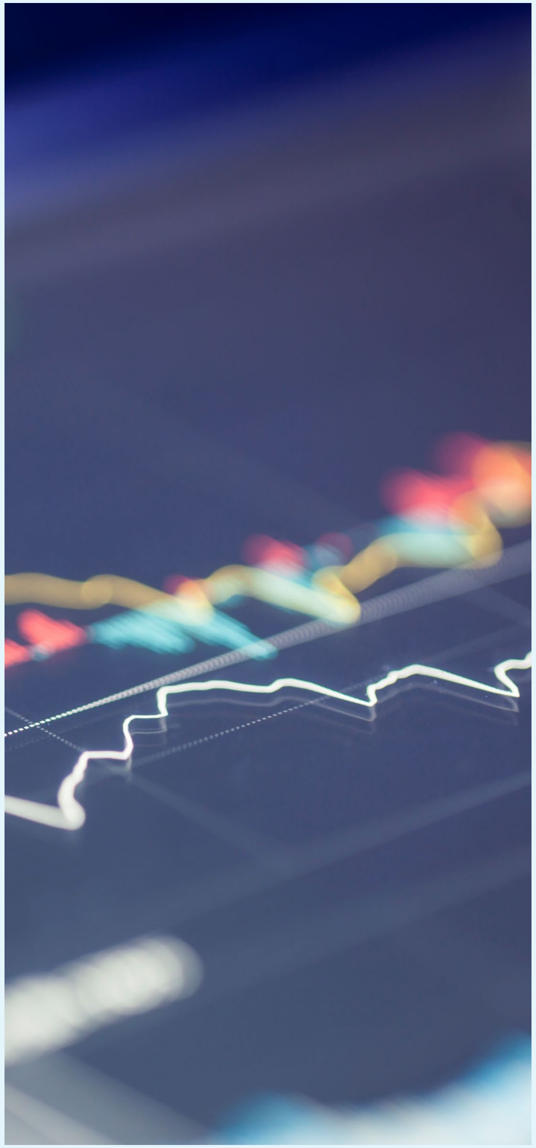
In this instance, the notice of meeting sent to the shareholders must be accompanied by an independent expert's report providing an opinion on whether the share issue to the creditor is fair and reasonable to the non-associated shareholders.

Shareholder approval under the Corporations Act - 20% level exceeded

If a particular lender (or their associates) will be issued more than 20% of the company's issued shares as part of a debt for equity swap, or if already holding above 20% would increase their holding by more than 3%, after the debt for equity swap, the takeover provisions in Chapter 6 of the Act apply.

An issue of shares in these circumstances requires shareholder approval by ordinary resolution (50%) and the notice of meeting to shareholders must be accompanied by an independent expert's report. The independent expert's report must set out the expert's opinion on whether the share issue is fair and reasonable to non-associated shareholders.

See our separate notes on capital raising and convertible notes which outlines some of the issues involved. Catching PIPEs in the wave of COVID-19 capital raisings.



Structure 2
Solvent creditor schemes

COVID-19 implications

It is possible for a company to implement a scheme of arrangement among a class of creditors while it continues to carry on business. The Directors' Moratorium and/or Safe Harbour Defence may provide some protection for directors to keep the business running while at the same time implementing a restructure with its creditors by a creditors scheme.

Overview

A creditors' scheme of arrangement is a process by which a company proposes a restructuring among a class of its creditors whereby those creditors compromise their claims against the company in exchange for some form of consideration. The scheme requires court approval, following its approval by specified majorities of creditors at the scheme meeting convened by the court. If the specified majorities of creditors and the court approve the scheme, the rights of scheme creditors are varied or limited by the terms of the scheme.

Creditors' schemes of arrangement can be used for both private or public companies to effect compromises with creditors such as debt for equity swaps.

The advantage of a creditors' scheme of arrangement is that it binds all the creditors in the class once approved at the scheme meeting and by the court. Through this process, creditors can be forced to take shares as repayment of the debt even if a creditor voted against the scheme and did not agree to the restructure.

Moratorium on Creditor Enforcement Action

Under s411(16) of the Act, once a scheme is ‘proposed’, the Court can order in effect a moratorium restraining any civil action against the company effectively providing the company a window to implement the scheme without creditors taking action. In the Boart Longyear matter, the Court considered that a scheme may be considered proposed for this purpose as early as when draft creditor scheme documents are lodged with ASIC.

Actual or potential class action shareholder claims can potentially be extinguished

Another advantage of a creditors scheme is that it can cover "subordinate claims" ie. claims, or potential claims, by shareholders under possible class actions. For example allegations against a company for not complying with the continuous disclosure regime for ASX listed companies or for inaccuracies in its financial statements. An unsecured creditors scheme could be extended to cover potential class action claims and if there would be no return to such claimants on a liquidation then under s 411(5A) of the Act the court can order such claimants be bound by the scheme even though no meeting of such claimants is ordered.

Ability to compromise secured creditor claims

A key advantage of a creditors scheme of arrangement over a DOCA (discussed in Structure 3) is that it allows for claims of secured creditors to be compromised without their individual consent. With the ability to define the scope of the relevant creditor class, it may be possible for a company to have a broader class of secured creditors so that any objecting creditors would be outvoted at the secured creditors scheme meeting and therefore bound by the scheme.

A DOCA cannot bind secured creditors without the consent of the individual creditor.

Structure 2
Solvent creditor schemes

Pros and cons of a debt for equity swap through a scheme of arrangement

Pros

- Solvent debt restructure (avoids external administration and associated negative publicity and loss of goodwill)
- Binds all scheme creditors, including dissenting scheme creditors' In particular, it can bind secured creditors under a secured creditors scheme, unlike a DOCA where secured creditors are only bound if they consent
- Directors remain in control of the company
- Company can continue to trade (for the benefit of shareholders and creditors)
- Effective releases can be given by creditors
- Ipso facto stay restricts exercise of termination or enforcement rights under certain contracts
- Flexible process that can accommodate a variety of restructures

Cons

- Court approval required (two court hearings)
- Relatively costly and lengthy process. Need to satisfy requisite majorities of 75% in value and 50% in number of scheme creditors' claims (present and voting), however upfront RSA should achieve this
- Strict procedural requirements
- Restructure is public subject to adverse publicity
- Susceptible to being blocked by a dissenting class of creditors where multiple class of creditors are affected by the scheme
- Impact on business reputation / trade creditor relations

Restructuring flexibility

A creditors scheme can be used to implement a variety of restructures such as:

- A debt for equity swap (capitalising debt);
- Transfer of assets to a new company and extinguishing debt in return for new debt/equity in the new company;
- Refinance or reset debt; and
- New debt or equity injection.

The creditors' scheme process is flexible in that it could be simply structured so the class of creditors receive a fixed number of shares issued at an agreed value for each dollar of debt owing. Thereby, they would extinguish all the debt in the class covered by the scheme. Alternatively, the restructure may involve a return of less than 100 cents in the dollar of debt compromised by issuing shares with a value less than the face value of the debt compromised.

The restructuring process may also be such that not all the debt is extinguished and the terms of the existing debt is varied such as by amending covenants, extending maturity dates, and introducing a payment in kind alternative (ie. issuing more loan notes with a face value of the interest not paid in cash) at the option of the company to preserve cash. The consideration offered to compromise the debt can be as simple as an issue of ordinary shares to extinguish the whole debt. Alternatively, instead the restructure may involve the issue of a combination of shares and new debt with a new security structure, interest rate package and maturity profile.

It is also possible for the company to undertake two or more creditors schemes at the same time with different classes of creditors. The creditors schemes could be inter-conditional so approval must be obtained to all the schemes otherwise no scheme is implemented.

Structure 2
Solvent creditor schemes

Creditor classes

The company has some flexibility in determining how the class of creditors is defined. For example, if a company has previously raised debt funding through the issue of unsecured notes, it may seek to restructure the unsecured notes by proposing the notes be cancelled in exchange for the issue of shares. The willingness of the unsecured noteholders to agree with the restructure will depend where the value of the company's assets breaks into the company's total debt. If the unsecured notes are likely to receive a low or nil return in an insolvency scenario, then the unsecured noteholders may be willing to negotiate a restructure.

Section 411(1) of the Act contemplates creditors being segregated into appropriate classes, determined by their similar voting rights in light of their common interests. The constitution of separate classes of creditors will depend on whether their legal rights are so dissimilar that they should constitute a separate class for voting on the scheme. While the responsibility is on the company to ensure the appropriate formation of classes of creditors, the court may refuse to approve the scheme or direct the proper constitution of classes in advance.

The courts take into consideration the legal character and the rights and obligations of the creditors against the company and how these rights will be affected by a proposed scheme. For example, the courts will consider the existing rights against the company and how these rights differ to those of other creditors; the extent the rights are directly affected by the scheme and if the difference in rights make it impossible for a group of creditors to be considered as one class.

Example: Different classes of creditors

The Boart Longyear restructure involved a creditor scheme of arrangement for secured creditors and another unsecured creditor scheme of arrangement, interconditional on each scheme being approved by the relevant class of creditors and subject also to approval of the company's shareholders.

In the Boart Longyear creditor scheme, the NSW Court of Appeal issued a landmark decision on how different classes of creditors were to be grouped. The court found that where a company has a reasonable chance of becoming insolvent, creditors with different rights and benefits may be included under the same class for voting purposes.

In this instance, secured bond holders were treated in the same class as holders of the Centrebridge term loans. This is despite the fact that holders of the Centrebridge loans received an issue of 54% of the company's share capital for a reduction of interest going forward. Secured bond holders were to receive an uplift of interest (but were to receive no equity consideration) in exchange for the company having the right to elect to pay interest in kind instead of cash for a period and to extend out the maturity dates.

More details about the Boart Longyear debt-to-equity recapitalisation are on our website.

Structure 2
Solvent creditor schemes

Scheme voting

The advantage of a creditors' scheme of arrangement is that it binds all creditors in the class if the requisite voting threshold is reached at the creditors meeting and the scheme is approved by the court.

The required vote is:

- 75% by value of holders of the relevant debt which vote at the creditors meeting (in person or by proxy); and
- A majority in number of the creditors who voted at the meeting (in person or by proxy).

Scenario voting

Assume a company had issued $100 million of debt through an issue of unsecured loan notes, held by 30 creditors.

If holders of loan notes with a face value of $80 million vote at the creditors meeting, then creditors holding at least $60 million of the loan notes need to vote in favour of the scheme to satisfy the first element of the voting threshold.

If 20 creditors actually voted at the scheme meeting (in person or by proxy), at least 11 of the creditors need to vote in favour of the scheme to satisfy the second element of the voting threshold.

Foreign creditors

Where debts compromised under the creditors' scheme are governed by foreign law, the court needs to consider if the effects of the scheme will be recognised and be effective in the foreign jurisdiction. For example, in the Boart Longyear scheme, orders of the Supreme Court in NSW preventing creditors taking recovery action for non-payment of interest on USA bonds subject to a USA Indenture governed by New York law were recognised in New York preventing enforcement to enable the scheme to be implemented.

Third parties

A creditors' scheme can effectively extinguish creditors' claims against third parties. It is likely to be used where it's necessary to obtain a release by creditors of such claims.

Although a creditors' scheme cannot itself bind a third party, the scheme can be used to vary or limit a creditor's rights against a third party (ie. by the release or indemnity of the third party) provided the creditors receive a benefit in return for the benefit conferred on the third party and there is a sufficient link between the benefit conferred on the third party (e.g. release and indemnity) and the relationship between the creditor and scheme company, as creditor and debtor.

There are limits on the extent to which a creditors' scheme can purport to affect the property of a creditor that has no connection to the scheme company or the relationship of creditor and debtor between the creditor and scheme company.

A creditors' scheme can also affect creditors' proprietary rights in respect of the security granted to them by the scheme company.

Structure 2
Solvent creditor schemes

Steps to implement a creditors scheme of arrangement

Key steps to implement a creditors scheme of arrangement while the company continues to trade involves the following elements.

Agreement with key creditors

Agreement between the company and key creditors under a Restructuring Support Agreement (RSA) is obtained.

It is preferable the company enter an agreement with key creditors to support the restructure and the scheme. Ideally creditors holding 75% or more of the debt being restructured would be party to the RSA and agree to vote in favour of the scheme. This would mean one aspect of the required voting threshold for the scheme would be satisfied.

The agreement would require each of the signing creditors to vote in favour of the restructure and set out the consideration offered under the scheme, such as shares to be issued in the company in exchange for the debt, any amendments proposed to ongoing debt terms if any debt is to remain. The agreement would also be subject to necessary conditions precedent such as shareholder approval, FIRB etc.

Classes of creditors in schemes of arrangements

In structuring the scheme, the company must determine what creditors are to be bound by the scheme and whether those creditors must form separate classes for voting on the scheme.

Example: Releasing third parties

In Fowler v Lindholm, Re Opes Prime, there were several claims in contemplation of the affairs of the four related companies. The object of the scheme was to achieve a reasonable settlement for all parties. In this scheme, all the creditors (including legal proceedings and claims) were set to be released.

It was held that under section 411 of the Act, third party releases are permitted in schemes of arrangement. The court held a scheme is a flexible mechanism that assists insolvent companies so that they can avoid liquidation. Furthermore, if third parties receive a benefit, the creditors must receive something back. This was covered in this instance as due to the release and indemnity, the creditors received a larger sum.

Structure 2
Solvent creditor schemes

FIRB approval

FIRB approval may be required. Similar issues apply as for Structure 1 if foreign persons are creditors and will receive equity under the scheme above the key thresholds permitted under the FATA.

Scheme process

In summary, the process to implement a creditors scheme of arrangement requires:

- Preparation of an Explanatory Memorandum (EM), usually accompanied by an independent expert's report setting out whether the scheme is fair and reasonable to scheme creditors
- The draft EM is submitted to ASIC for review
- Following the ASIC review period, the EM must be approved by the court (first court hearing)
- Once the EM is approved by the court, a notice of meeting is dispatched to scheme creditors (with a minimum of 21 days' notice period)
- At the creditors' scheme meeting, creditors vote on the scheme
- If creditors approve the scheme at the scheme meeting, the matter is brought back before the court (second court hearing) for court approval of the scheme
- If the court approves the scheme, it is implemented shortly following court approval.

Timetable of creditor schemes

Below is a general indicative timetable for the creditor scheme process, which takes approximately 3 months from the date the RSA is signed / announced to the date the scheme is implemented.

Day 1	Scheme restructuring implementation agreement and announce
Day 28	Draft scheme booklet for ASIC to review
Day 44	**First court hearing**
Day 51	Dispatch notice of meeting and explanatory statement
Day 81	Scheme meeting to consider and approve scheme
Day 86	**Second court hearing (all conditions satisfied/waived)**
Day 87	Court orders lodged with ASIC (copy to ASX)
Day 94	Record date – for determining entitlements
Day 96	Implementation date – scheme consideration provided to creditors or shareholders

Additional steps for public companies

Where the scheme involves an ASX listed company:

- Shareholder approval will be required if the consideration offered under the creditors scheme would exceed the number of shares the company can issue under its placement capacity. This is uplifted from 15% to a maximum of 25% under the recent temporary amendments to ASX listing rules provided a follow-on capital raising is offered to existing shareholders at the same price such as through a right issue or share purchase plan;
- Shareholder approval under ASX Listing Rule 10.11 is required if the lender is (or was in the previous 6 months) a shareholder holding 10% or more of the issued shares and has a nominee on the board, or holding 30% or more of the issued shares; and
- Shareholder approval would take place in parallel with the creditors scheme process so the shareholders meeting would be held before the date of the Second Court Hearing for the creditors scheme. Given the shareholder apporval process can take place in parallel with the creditors scheme process, this should not delay the creditors scheme.

Creditor scheme examples

BIS Industries

BIS Industries is a private company that utilised creditors schemes of arrangement to implement a restructure. This restructure was effected by various steps, including two creditors schemes of arrangements. In the first scheme of arrangement, shares in a subsidiary of BIS Industries were transferred to senior creditors in exchange for releasing the creditors guarantee and security requirements. The scheme also provided that the creditors would be subject to a standstill, therefore unable to commence enforcement proceedings originally permitted under the finance documents. Furthermore only 80% of the senior creditors (instead of 100% threshold provided under the finance documents) would need to provide consent for the restructure.

A second scheme of arrangement was entered with noteholders, which approved the transfer of the shares in the subsidiary of BIS Industries to an entity owned by the senior creditors, in exchange for the noteholders receiving 4% of the shares in the entity on implementation. This restructure highlighted the relevant flexibility in private sector creditor schemes of arrangement.

Atlas Iron Limited

In Re Atlas Iron Limited [2016] FCA 366, the Court approved a creditors' scheme that relied on section 411(5A) of the Act to release (subordinated) shareholders' claims, without requiring a meeting of those subordinated creditors to be convened to consider or vote on the scheme. The Independent expert report stated that subordinate claim holders would receive nil return on an external administration winding up. On that basis, the court held that there appeared to be no objection to Atlas' proposed use of section 411(5A) of the Act to propound a scheme that has the effect of releasing subordinate claimants' claims against the company (except to the extent of any net insurance proceeds which might be available).

The difficulty with relying on s 411(5A) is that if the independent expert report were to find that the company is solvent and thus shareholders claims (albeit subordinated) are still likely to have some residual value in a liquidation scenario, the court will unlikely preclude those shareholder claimants from voting on the scheme, in which they may have a real financial interest. It will therefore be necessary to demonstrate (ideally at the first hearing) that subordinate claim holders have no economic interest in the assets of the scheme company. This will require the independent expert report to opine on enterprise value and contain a positive opinion about the dividend that might be paid to a subordinated claim holder in a winding up.

Channel Nine

The Nine scheme, was opposed by a minority of the senior lenders, representing about 12% of the debt. The minority senior lenders opposed the scheme on the basis that if the scheme was approved they would be forced to accept equity in the Nine group holding company without their consent in breach of section 231 of the Corporations Act.

It was also argued that the senior lenders should be divided into separate classes on the basis that Apollo and Oaktree would have the right to appoint directors and control the board of Nine. This was significant as Apollo and Oaktree held 45% of the senior debt. The court also rejected this argument holding that the differentiation of rights did not destroy the ability of creditors to consult together. The court's endorsement of the Nine scheme has clarified that if creditors holding 75% or more of the debt under a syndicated loan vote for a scheme, minority lenders can be forced to accept equity in the debtor.

Structure 3
Alternatives in administration

COVID-19 Implications

In light of the current COVID-19 circumstances, companies may become insolvent and may have no other option but to enter into external administration.

While entering administration will cause more disruption to the business than the other two debt for equity structures outlined in this paper, a company under administration can take additional restructuring steps such as terminating onerous contracts which may be necessary as part of the restructuring to become solvent again. The company may also enter into a holding DOCA to provide time for key stakeholders to develop an alternative restructure proposal.

Available options

Two of the most common forms of external administration are voluntary administration, which may result in a restructure by deed of company arrangement, or liquidation. Another option is a creditors' scheme of arrangement, as outlined in Structure 2.

For a company that is insolvent or likely to become insolvent, the company may:

- Enter into voluntary administration with the aim of resolving the company's future quickly and efficiently, with creditors determining whether to enter into a DOCA to compromise creditors' claims, enter into liquidation or return the company to the directors; or
- Propose a creditors' scheme of arrangement in order to compromise the claims against the company.

Administration

A company may initiate a voluntary administration by appointing an administrator where the board considers the company is insolvent or likely to become insolvent at some future time.

Once the company enters into voluntary administration, control of the company passes from the board to the administrator (although management usually remains). The appointment of an administrator can address solvency concerns and provide some protections for directors.

The administrator controls the company's business and generally has broad powers to continue, terminate or dispose of its business or property. A stay or moratorium applies during the administration to prevent third parties exercising certain rights or pursuing legal action against the company. This gives the administrator an opportunity to investigate the affairs of the company and prepare its report to creditors.

The administration process involves two meetings of creditors. The first meeting is for creditors to determine whether to replace the administrator and establish a committee of creditors. The second meeting is for creditors to determine the best course of action for the company in the circumstances.

The administrator provides creditors with a report on the affairs of the company and its view on the best available outcome. Creditors may decide a DOCA is the most favourable outcome to address the company's financial circumstances.

In the absence of a DOCA, creditors may end the administration and return control of the company back to the directors or resolve to wind up the company.

Structure 3
Alternatives in administration

Deed of Company Arrangement (DOCA)

A DOCA enables a restructure by compromising the claims of creditors. A DOCA binds the company, its shareholders and its creditors, but not secured creditors who do not vote in favour of the DOCA.

Restructuring through a DOCA is flexible and fast, with low voting thresholds (majority in number and value). Creditors' rights are suspended.

Creditors vote in a single class (although a separate employee vote is required to compromise priority claims and a DOCA approved on votes of related parties is liable to challenge).

While court and ASIC approval may not be required, the DOCA can be challenged after the event.

A DOCA can be used for various arrangements including debt for equity swaps or to provide an extension of the statutory moratorium on creditor claims against the company while an alternative proposal is developed by key stakeholders.

An alternative proposal may involve a creditors' scheme of arrangement.

For more detail see the following link https://www.minterellison.com/articles/covid-19-use-of-holding-docas

Pros

- Efficient, flexible and fast
- Avoids court involvement (except for deed administrator requesting leave)
- Low voting thresholds (majority in number and value)
- Moratorium – creditors' rights suspended

Cons

- Creditors determine the outcome for the company
- Cram down of secured creditors not possible
- No distinction of classes of creditors and so voting is by all creditors as one whole group.
- DOCAs cannot extinguish creditors' claims against third parties

Change of control

The DOCA can be used to pass control from shareholders to the restructure sponsor and a new board. A deed administrator has the ability to seek leave of the court to compulsorily transfer 100% of the shares in a company, without the consent of shareholders pursuant to section 444GA of the Act.

The court will grant leave if it is satisfied the transfer of shares would not unfairly prejudice the interests of shareholders. Shareholders' interests are likely prejudiced where the shares hold residual value. If there would be no return to shareholders on a liquidation of the company's assets, the shares will have no residual value. This process requires an expert report where the expert's opinion is that the shares are of no value.

Structure 3
Alternatives in administration

Example: Shareholders do not vote on the DOCA

Channel Ten's $200m facility with CBA (expiring 23/12/17) was guaranteed by its largest shareholders (Packer, Murdoch and Gordon). CBA, as security trustee, held security for repayment of its loan and fees due to the shareholder guarantors for the provision of their guarantees. There were also trade creditors of $215 million and approximately $73 million owed to financiers, and additional production payments to studios (CBS and Fox) would fall due in the second half of FY17.

Packer, Murdoch and Gordon advised the TEN board that they would not extend or renew their guarantee of the CBA facility and that they may pursue the directors for insolvent trading if the company continued to draw the CBA facility. The directors appointed voluntary administrators and then CBA appointed receivers and managers. ACMA / media law reform playing out mooted which would allow B&I to acquire ownership.

The case highlighted two main points. The first being that pre-appointment work by administrators is permitted if the engagement is limited and does not involve advice to the board, management, creditors or stakeholders regarding the management of TEN, managing the affairs of TEN, its insolvency, or the obligations and duties of the boards, individual directors and management.

The second point is that shareholders do not get a vote. Murdoch and Gordon argued that shareholders should be permitted to vote on the DOCA however the Court upheld that section 600H of the Act (introduced to overturn the case of Sons of Gwalia) applies to voluntary administration meaning shareholders have no right to vote.

Structure 3
Alternatives in administration

Example: Oroton Group

Oroton Group appointed voluntary administrators on 30 November 2017. Oroton received credit support from a major shareholder up to an amount of $3 millon and entered into a secured $35 million facilities agreement with Westpac in 2015, and the term was extended from 10/17 to 4/18. Westpac and the major shareholder entered into a put and call option, because there were concerns regarding the Westpac debt and security over Oroton, and the rights were exercised in 11/17.

To commence the sale and recapitalisation process, Oroton entered into an implementation deed granting exclusivity to the major shareholder as it was considered a better alternative than the other offers received by the voluntary administrators (by comparing the estimated unsecured creditor return). The consideration provided by the major shareholders consisted of secured debt, employee entitlements for continuing employees and a top up amount which ensured a return to unsecured creditors (totalling $24.45 million). A DOCA was entered into, subject to an order under section 444GA of the Act transferring shares in the company and thereby control to the major shareholders.

Example: Mirabela Nickel

In 2013, Mirabela Nickel Ltd had a highly leveraged capital structure and defaulted on its loan payments due to unsecured noteholders. It undertook negotiations with the noteholders which led to several noteholders putting in new debt and 65% agreeing to a recapitalisation plan.

Mirabela and its Australian subsidiary entered into a DOCA providing for the extinguishment and compromise of the unsecured notes in exchange for 98.2% of the shares in the listed parent, with the shares being compulsorily transferred pursuant to section 444GA of the Act. Existing shareholders were ordered to transfer 98.2% of their shares but continued to hold 1.8% of their shares following completion of the DOCA.

In addition, secured convertible notes were issued to provide new capital, requiring the issue of a prospectus and standstill arrangements with secured creditors at the Mirabela Brazil level. Amounts due to other unsecured creditors and employees were preserved. It also provided that once the restructure was completed, the DOCA would terminate and the control would revert back to the directors.

Structure 3
Alternatives in administration

Example: Paladin

In 2017, Paladin went into administration and entered into a DOCA with the deed administrators to initiate a capital restructure.

The DOCA contemplated the transfer of approximately 98% of the ordinary shares to certain creditors and other investors in exchange for the extinguishment of the majority of Paladin's existing debts. Existing shareholders were to retain 2% of their holdings in Paladin.

The court found:

- The deficiency in the company's assets against its debts meant its equity had no residual value on a going concern basis, on a 'distressed' going concern basis or in a liquidation, and that a liquidation was the likely outcome of a failure to approve the transfer of shares; and
- It followed there was no unfair prejudice to shareholders in the transfer of shares.

In accordance with the DOCA, Paladin also raised US$115m pursuant to the issue of new secured notes and was reinstated on the ASX.

Example: New Bounty

Re New Bounty Pty Ltd [2015] NSWSC 106; 107 ACSR 504 involved a DOCA under which new shares were issued in consideration for the discharge of outstanding interest but not the principal on an intra-group loan.

The powers conferred on deed administrators by default under Sch 8A of the Act are more specific than the broad statutory power of management under s 437A and do not provide a general management power that would allow new share issues to be made.

The default provisions in Sch 8A can be replaced by an arrangement where existing management are expressly given some power (including the power to issue shares) under the DOCA: s 444A(5); Reg 5.3A.06.

If the DOCA does not exclude the management powers of the directors, then they retain the power to issue shares, although being bound by the DOCA they must not do so inconsistently with the operation of the DOCA: s 444G.

Whoever issues the shares during a DOCA, the power must be exercised for a proper purpose under s 181. It has been held that it is not necessarily an improper purpose to issue shares in order to obtain control of a company where the transaction is providing necessary capital to the company in exchange for the share issue, particularly if there are no other funding sources.

Creditors’ scheme of arrangement under administration

Implications

While a DOCA is generally a preferred restructuring mechanism due to its efficiency and potential to avoid court involvement, a creditors’ scheme of arrangement when under administration is also an option, and:

- If successful, will bind dissenting secured creditors; and
- Will be voted on by those classes of creditors whose rights are affected by it.

A creditors’ scheme of arrangement will require a company to show that the compromise or arrangement by the creditors scheme of arrangement will have the effect that the company will be solvent.

The creditors and the company would need to negotiate and reach agreement on the terms of the restructuring arrangement, being the amount of the debt that will be repaid by the issue of the shares, the issue price of the shares and any pre-conditions which need to be satisfied, such as any necessary shareholder approvals and FIRB approval.

If the arrangement will only capitalise some of the debt, then the agreement must deal with the changes to the terms of the remaining debt arrangements.

The same considerations and steps apply as set out in Structure 2.

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