Article Information

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Boart: a landmark decision for reconstructions

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On 1 September 2017, Boart Longyear Limited (**Boart**), successfully implemented the reconstruction of its US law governed debt using Australian creditor schemes of arrangement (**Schemes**).

This is a landmark case that will influence Australian corporate reconstructions for years to come.

The case involved approval by the NSW Supreme Court and recognition by the US Bankrupcty Court under Chapter 15 of the US Bankruptcy Code, ensuring cross border effectiveness for the reconstruction.

Mark Williamson, **partner,** and **Chris Lyons**, **senior associate**, discuss this landmark decision.

Highlights

- US Bankruptcy Court ruled that the Australian Court approved Schemes are recognised under Chapter 15 of the US Bankruptcy Code. This effectively made the reconstruction of New York law governed debt by the Australian Schemes binding under US law.
- The transactions resulted in major creditors becoming major shareholders of an ASX listed company, without breaching Australia's takeover offer laws.
- Creditor class composition and fairness issues were extensively explored by the Court. Class composition was unsuccessfully contested at the First Court Hearing. Even though it was argued the outcomes for creditors within a class were unfair, fairness was left for determination at the Second Court Hearing.
- Shareholders unsuccessfully argued that the Court should not exercise its discretion in relation to the Scheme and have regard to the interests of those other than creditors. The Court also rejected shareholder submissions regarding an alternative Scheme which would strike, "a fairer balance between creditors and shareholders," finding that the Court should not consider a Scheme by postulating other alternative Schemes which do not exist.
- The Australian Court took the unusual step of ordering mediation with the objectors, which resulted in the objecting creditor striking a deal to change the Schemes. The objecting creditor then dropped its assertion that the outcome of the Schemes was unfair.
- The Australian Court ruled that it has power under the Corporations Act to approve Schemes that have been substantively and materially amended after creditor voting has taken place.
- The Australian Court confirmed that beneficial holders of Notes, held through depositary systems – in this case DTC, are "contingent" creditors and therefore "creditors" under section 411 of the Corporations Act.
- The Australian Court hearing and orders coincidentally made the share issuance by Boart to the major creditor exempt from the public offering registration requirements of the US Securities Act under Section 3(a)(10).
- The Schemes survived two appeals to the NSW Court of Appeal.

The Proposed Restructuring

Boart sought to restructure its US law governed debt by entering into a Restructuring Support Agreement with some, but not all, of its major creditors, Centerbridge, Ares and Ascribe. The Restructuring Support Agreement provided for additional director appointment rights for these major creditors.

Boart also entered into a Subscription Agreement which provided for the issuance of a significant number of shares to its major creditor, Centerbridge. The proposed issuance of shares to Centerbridge was highly dilutive on the other

Shareholders, and had implications under Australian takeovers law. Under the original proposal, the Centerbridge parties would hold 56% of the diluted share capital of Boart following the restructure.

Boart sought to implement the restructure of its US law governed debt through two schemes of arrangement:

- A scheme between Boart and holders of 7% Senior Unsecured Notes for approximately US$294 million (**7% Creditors Scheme**); and
- A scheme between Boart, holders 10% Senior Secured Notes (US$204m) and creditors under two term loan arrangements (approximately US$250m in aggregate) (**Secured Creditors Scheme**).

The Schemes were conditional on the highly dilutive share placement being approved by Boart shareholders.

The First and Second Court Hearings on the Schemes were heared by Justice Black in the NSW Supreme Court.

Using Australian Schemes to reconstruct Cross-Border Debt

How can an Australian court approved Scheme of Arrangement be effective to modify US law governed rights and obligations of creditors?

Boart had 4 types of US law governed debt that it was seeking to restructure:

- 7% Senior Unsecured Notes pursuant to New York law governed Notes and Indentures, issued pursuant to US law, held in global form by the US depositary, DTC, and with a US trustee.
- 10% Senior Secured Notes pursuant to New York law governed Notes and Indentures, issued pursuant to US law, held in global form by the US depositary, DTC, and with a US trustee and a US collateral agent.
- Term Loan A secured debt pursuant to a New York law governed credit agreement; and
- Term Loan B secured debt pursuant to a New York law governed credit agreement.

The restructuring of these debts is effective under Australian law, when the Schemes are approved by a Court and lodged with ASIC, but what about under US law?

There was a risk that a dissenting Scheme Creditor could commence a lawsuit or take other actions in the United States, which would potentially jeopardise the restructuring.

Chapter 15 of the US Bankruptcy Code provides a solution to this risk by giving the US Bankruptcy Court power to recognise the Australian Scheme Proceeding as a *"foreign main proceeding"* under *"a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purpose of reorganization or liquidation"*. Chapter 15 then gives the US Bankruptcy Court power to grant recognition of the Schemes and enforcement of their injunctive and release provisions.

Boart successfully obtained these orders from the US Bankruptcy Court in New York, which effectively gave the Australian Scheme Court orders force under US law.

Beneficial holders of the Global Notes can vote at Creditor Meetings

Cross-border Note offerings are commonly structured with the Notes being legally held by a depositary and beneficial interests in the Notes being traded using book entry trading systems facilitated by The Depositary Trust Company (**DTC**), Euroclear and Clearstream.

Boart's 7% Senior Unsecured Notes and the 10% Senior Secured Notes were held in global note form by DTC. Accordingly, the only "legal" creditor in respect of Boart's Notes was DTC.

The NSW Supreme Court decided that the beneficial owners of the Notes are "contingent" creditors and would be entitled to vote on the Schemes. The Court approved arrangements whereby voting for the Schemes was carried out using a complex system of proxy forms and proofs of debt.

The registered Noteholder provided an omnibus proxy form which appointed as its proxies the 'Registered Participants' shown in its records as holding interests in the Notes. These Registered Participants were typically investment banks who were not the ultimate beneficial holders. However, the actual ultimate beneficial holders were then able to provide Proof of Debt Forms to their Registered Participants, which were then used in the voting. The Chairperson of the creditors meetings was given discretion to accept or reject a Noteholder's claim by reference to the information in the Voting Proof of Debt Form.

The Objections

The Schemes were challenged by First Pacific (a creditor and holder of approximately 27% of the 10% Secured Notes). The Schemes were challenged on a variety of grounds at various stages, including:

- that First Pacific and the other 10% Secured Noteholders (or the 10% Secured Noteholders not aligned with Centerbridge) should be in a separate voting class for the Secured Creditors Scheme; and
- that the Schemes are not fair to the 10% Secured.

The Schemes were also challenged by minority shareholder objectors on the grounds that:

- Schemes should not be approved because they are not fair to Shareholders, including because the valuations on which the Schemes were based did not take into account the improving financial outlook for the companies;
- the Court's approval of 'substantive and material' amendments to the Scheme following the creditors' meetings went beyond the Courts powers to approve amendments to the Scheme under section 411(6) of the Corporations Act; and
- the substantially amended Schemes were so different to the description of the Schemes disclosed to shareholders when the shareholders approved the equity issuances to Centerbridge, and others, that those approvals were invalidated. In particular, the shareholder argued that the Scheme's condition precedent requiring shareholder approval of the share issuance failed, because the shareholder vote should not be considered valid.

Decision on class composition

These Australian Court decisions reinforce the position that "class" issues should be determined at the First Court Hearing, but "fairness" issues should be considered at the Second Court Hearing.

First Pacific, challenged the Secured Creditors Scheme on the basis that the classes of creditors were incorrectly constituted.

With 27% of the Notes, First Pacific would have had a blocking stake to prevent the 75% approval threshold required of a Scheme creditors meeting, if the Secured Creditors Scheme only applied to the 10% Secured Notes or if Secured Noteholders voted as a separate class. However, by combining the 10% Secured Notes with the Term Loan A and Term Loan B creditors in the same Scheme , First Pacific's interest was diluted to below a 25% blocking stake.

At the First Court Hearing, First Pacific argued that the interests of the Secured Noteholders and the holders of the Term Loan A and B debt were diametrically opposed to each other on a range of issues and, in particular, the following matters were class creating:

- the issue of shares to certain creditors, waiver of change of control rights and director appointment rights; and
- the differential interest regime in the Secured Creditors Scheme for the 10% Senior Secured Notes and the creditors under the term loan arrangements.

The Courts found that these distinctions were not sufficient to be class creating because the 10% Secured Noteholders and Centrebridge as the TLA and TLB holder faced a common and imminent issue as to the insolvency of Boart.

The New South Wales Court of Appeal affirmed the old common law test for class composition set out in *Sovereign Life Assurance Company v Dodd* that a class may be comprised of persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. The Court of Appeal also noted the relevance of the following matters to class composition:

- What rights do existing creditors have against the company and to what extent are they different?
- To what extent are those rights differently affected by the scheme?
- Does the difference in rights, or different treatment of the rights make it impossible for the creditors in question to consider the scheme as one class?

This decision reinforces that creditors receiving vastly difficult commercial outcomes can constitute the same class for Scheme voting purposes.

Fairness – Court ordered mediation where there are objectors – the Court's power to amend the Scheme if a deal is reached with objectors

Before ruling on the "fairness" issue, Black J took the unusual step of ordering that the parties attend mediation during an adjournment to the Second Court Hearing for the Schemes.

Following mediation, the major supporting creditors reached agreement with the objecting Creditor to substantially change the transaction after the creditors had already approved the Schemes. The new deal gave the objecting Creditor,

and the other Secured Noteholders, a significantly better outcome than contained in the version of the Secured Scheme already voted on at the Creditors Meeting. This resolved First Pacific's objection to the Schemes and the only remaining objectors were shareholders.

No agreement was reached with the objecting Shareholders

Can the Court approve material and substantial amendments to a Scheme after it has been approved by creditors (members)?

In this case, the answer was yes.

The Court approved the Schemes with substantial amendments to reflect the new deal. The Court approved these amendments, notwithstanding that:

- the amendments were made after the Scheme meetings had taken place; and
- the amendments were of a substantive and material nature.

The Shareholder objectors challenged the amendments to the Schemes on the ground that they went beyond the Court's power to approve amendments. These challenges were unsuccessful at the Supreme Court and NSW Court of Appeal and the amended Schemes were implemented.

Ordering mediation may now become more frequent in situations where the Court has concerns about the fairness of a Scheme. This case shows that mediation or negotiations with objectors, even after creditor approval has been obtained, can be effective.

Australian Takeover law issues

The share placement to Centerbridge would have breached the Australian takeover law's de facto prohibition on acquiring a stake of 20% or more of an Australian public company, unless an exemption applied.

The Schemes were also subject to a condition precedent that the highly dilutive share placement be made to a number of creditors, including Centerbridge, who would gain *de jure* control of Boart following the restructure.

Boart obtained shareholder approval for the share issuance under Item 7 of section 611 of the Corporations Act to satisfy the condition precedent and, to provide Centerbridge with a valid exemption from the de facto takeover law prohibition.

The objecting shareholder failed in its argument that the significant changes to the transaction, reflected in the amended Schemes, meant that the Shareholders vote should not be considered effective.