Ashurst Australia
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Restructuring & Insolvency Alert

Federal Court approves Nine Entertainment debt for equity swap

WHAT YOU NEED TO KNOW

- The Federal Court of Australia has approved a debt for equity swap to convert the senior and mezzanine secured debt of Nine Entertainment to equity notwithstanding some opposition from minority senior lenders on the grounds that they should not be compelled to do so in place of their secured debt.
- To the extent that there was any doubt about the ability of an Australian court to scheme dissenting secured lenders, this doubt has been resolved by the decision of Jacobson J to approve the Nine scheme which has the effect of converting all of the debts and security rights of senior and mezzanine creditors to equity as part of the restructuring of the company; see *Nine Entertainment Group Limited, in the matter of Nine Entertainment Group Limited (No1)* [2012] FCA 1464.
- As such, secured lenders in Australian syndicates remain liable to be schemed into equity if 75% or more of lenders by value and a majority in number vote in favour of the scheme.

Implications of the decision

Australia remains one of the most secured creditor friendly jurisdictions in the world. Australia's insolvency rules continue to provide virtually unfettered priority and enforcement rights to secured creditors with enforceable charges over all or substantially all of the assets of the debtor under both the voluntary administration and liquidation regimes. This system of strong secured creditors' rights is to be contrasted with the Chapter 11 procedure in the United States and indeed, certain features of the UK Insolvency Act which substantially restricts the rights of secured lenders to pursue non-collective insolvency procedures.

The Australian insolvency system has traditionally protected the enforcement and priority rights of secured creditors unless they agree to vary them. Even the *Alinta* and *Centro* schemes of arrangement can be characterised as, in substance, consensual arrangements rather than arrangements approved in the face of opposition from senior lenders. As such, the Nine scheme of arrangement represents the first time that a Court has decided that secured lenders to an Australian company can be compelled to accept equity in the face of their opposition.

The approval of the Nine scheme by the Court highlights that these principles are subject to an important exception, namely; that if the majority of creditors holding 75% or more of the debt under a syndicated lending structure vote in favour of the scheme, the minority lenders are liable to be schemed to accept equity in the debtor. This is, of course, the position in the UK and has been so for some time.

Grounds of opposition

A number of the original lenders to Nine objected to the proposed scheme at the first hearing on two principal grounds; namely:

- that section 231 of the *Corporations Act 2001* (Cth) (the "Act") prohibited the allocation of shares to a person without their express or implied consent; and
- that the scheme classes had not been properly constituted by reason of certain director appointment rights attaching to creditors holding less than 50% of the senior debt in Nine.

In response to these objections, Jacobson J found as follows:

- section 411 of the Act empowers a court to override the effect of section 231 of the Act and that secured lenders may be required to accept shares in the company in full satisfaction of their claims as creditors; and

- the director appointment rights enjoyed by some of the senior lenders did not create new or additional rights which made it impossible for the senior lenders to consult together about the scheme at the scheme meeting (which is the traditional class test).

Accordingly, his Honour convened the scheme meetings at which the scheme was approved by the requisite majority.

The scheme has now received the final approval of the Court at the second scheme hearing on 29 January 2013.

Although it was open to do so, no secured creditor opposed the scheme at the second hearing on fairness grounds. Such an objection of course remains open to dissenting lenders if there is some specific factual basis to make that case, particularly if lenders disagree with the valuation adopted by the scheme. For an example of an unsuccessful challenge by mezzanine lenders to the senior lender valuation adopted for a UK scheme, see *Bluebrook Ltd, Re* [2009] EWHC 2114 (Ch), [2010] BCC 209 (more commonly known as the *IMO* decision).

Conclusion and implications

The Nine scheme is an important milestone in the history of the Australian restructuring market.

The decision is positive for debtors looking to promote schemes to reconstruct their balance sheets whilst avoiding formal insolvency appointments. The decision also supports the continuing development of the secondary debt markets in Australia as banks will elect to sell debt rather than risk being schemed into equity which they do not wish to hold. For funds buying into that debt, it promotes their ability to override the objections of minority lenders in order to achieve their restructuring and control objectives.

Traditional secured lenders are expected to look at the decision less favourably on the basis that it detracts from the otherwise strong protection afforded to the rights of secured lenders in Australia. No doubt some effort will be undertaken in future leveraged deals to structure around scheme risk if that is possible. Of course the best protection is either bilateral arrangements or holding sufficient of the debt to block any scheme proposal.

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