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MAJOR TRANSACTIONS - WHAT ARE THEY?

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A. Introduction

1. The purpose of this paper is to address certain questions which arise in a lending context regarding the meaning of "major transaction" in the New Zealand Companies Act 1993.

2. In his paper presented to last year's conference , Michael Jonas looked at the extent to which contingent liabilities should be valued in determining whether a transaction is a major transaction, and also looked at the consequences for third parties of a breach by a company of the requirement in section 129 for a major transaction to be approved by special resolution.

3. By way of background, under section 129 a company must not enter into a major transaction unless the transaction is approved by special resolution (ie: by a majority of 75 % or, if a higher majority is required by the company's constitution, that higher majority, of the votes of those shareholders entitled to vote and voting on the question) or is contingent on approval by special resolution.

4. The term "major transaction" is defined in section 129(2) as:

   "*(a) The acquisition of, or an agreement to acquire, whether contingent or not, assets the value of which is more than half the value of the company's assets before the acquisition; or*

   (b) The disposition of, or an agreement to dispose of, whether contingent or not, assets of the company the value of which is more than half the value of the company's assets before the disposition; or

   (c) *A transaction that has or is likely to have the effect of the company acquiring rights or interests or incurring obligations or liabilities the value of which is more than half the value of the company's assets before the transaction.*"

5. The particular significance of major transactions to the lender is that:

   5.1 if a major transaction is entered into in breach of section 129 and the other party (for example a lender) knew or ought to have known of that breach, then the contract might not be binding on the company and it is even possible that the other party may be liable on equitable grounds for any losses suffered; and

   5.2 if a major transaction is approved by special resolution, any shareholders who voted against the resolution have minority buy out rights under section 110 of the Act, which may obviously impact negatively on the company's balance sheet.

B. The Questions

6. In this paper I wish to focus on two issues, namely:

   6.1 the "value" of obligations or liabilities, for the purposes of paragraph (c) of the definition; and

   6.2 the "value" of the company's assets, for the purposes of paragraphs (a), (b) and (c) of the definition.

The Value of Liabilities

7. The question here is "How are obligations or liabilities valued in the context of a lending transaction?".

8. For example, where a company enters into a standby facility, presumably it is a major transaction if the total amount of the facility is more than half the value of the company's assets? Is there a "transaction" at all, where a facility agreement is entered into but no drawdown has occurred? And what if the company is not expecting to have to use the facility, at least in full? Must one inquire into the "likelihood" of the company borrowing more than half the value of its assets under the facility?

9. Similarly, what if the amount to be lent is less than half the value of the company's assets, but the aggregate of the principal and the amount of interest payable over the term of the loan is certain to exceed half the value of the company's assets? Has the company incurred obligations the value of which is more than half the value of its assets? On a literal interpretation, the answer must be "yes". But should interest be taken into account at all? One would like to think not.

10. And what about a refinancing transaction? What if the company has a loan outstanding which is more than half the value of its assets, and which was authorised by a special resolution at the time it was put in place. The company now wishes to refinance that borrowing - is this a major transaction? Does it depend on whether the terms of the new borrowing fall within what the shareholders originally approved? And what if this refinancing is in the context of a further acquisition? For example, what if:

    10.1 the value of the company's assets is $25m;

    10.2 the company has existing borrowings of $15m;

    10.3 the company proposes to acquire a new business having a value of $10m; and

    10.4 the company proposes to refinance the existing $15m loan and partially fund the acquisition, by entering into a new loan of $20m?

11. Is it possible in this example to effectively "net" the obligations being incurred by the company and say that the new liabilities being undertaken are no greater than $10m so that this is not a major transaction? Or must one adopt a very literal approach and require that the various liabilities be aggregated (purchase at $10m + new loan of $20m = $30m)? or is it necessary to separate these transactions, so that the acquisition itself is not a major transaction, but the new borrowing of $20m is?

12. And what if a company seeks to extend a loan, which is greater than half the value of its assets, beyond its existing maturity date? Does it help that the loan agreement expressly

provides for the term to be extended by agreement between the parties? Can it be said that the shareholders in approving the transaction at the outset effectively authorised it for a period longer than the initial term? But what if the borrowing was not initially authorised by special resolution (because, for example, at the time it was entered into the amount of the loan was less than half the value of the company's assets) - does the extension of the term itself constitute a major transaction?

Some Answers?

13. Unfortunately there are no hard and fast answers to the questions referred to above. There have not yet been any cases decided in New Zealand to assist in this respect.[1] In most instances, of course, the lawyers are likely to adopt a conservative approach and obtain the authority of a special resolution in cases of doubt. In most cases this will not be a major hurdle because the company will have closely held shares. But for listed companies and companies which are unlisted but whose shares are widely held the requirement to pass a special resolution can be a time-consuming and expensive exercise.

14. It would be nice to think that if and when these questions come before the courts, the judges will adopt a commercially pragmatic approach. For example:

    14.1 They may well accept the concept of "netting" referred to above. In other words, the refinancing of an existing loan on terms no less beneficial to the company, where the amount borrowed is no greater than the existing loan, might be regarded as not being a major transaction if the existing borrowing was approved by a special resolution. And in the example referred to above, the court could hold that since the "new" liabilities being undertaken are really only $10m, which is less than half the value of the company's assets, the transaction is not a major transaction.

    14.2 The courts may adopt an accounting value of the liabilities being incurred, rather than the face value of those liabilities. For example, in the case of a lease the court might accept that the value of the obligations being incurred is the present value of the payments due under the lease, or only that amount which must be recognised as a liability under the applicable accounting standard, and not the aggregate of the rentals due over the entire term.

    14.3 The courts might adopt a "purposive" approach to the interpretation of the definition. After all, as the Law Commission stated before the section was enacted, the section was intended to protect shareholders from transactions having such far-reaching effects that they transformed the company they invested in without warning.[2] The courts may therefore avoid interfering where a transgression has been minor, especially where it was a matter of fine judgment exactly what the value of the company's assets was.

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[1] The Canadian cases are equally unhelpful. The Ontario Business Corporations Act requires shareholder approval of a "sale, lease or exchange of all or substantially all" of the company's property. Approval is not required to borrowing or giving security.

[2] As a Canadian court put it (in Cogeco Cable Inc v CFCF Inc [1996] R.J.Q. 278):

> *"... whether the proposed transaction constitutes a fundamental reorientation which strikes at the heart of the company's activities, in other words whether this is a transaction which is out of the ordinary and which substantially affects the company's purpose and existence ..."*

15. All the above is, of course, conjecture. Until we have the benefit of judicial comment on the section, lawyers (being generally cautious people) will no doubt continue to be conservative in their approach to the interpretation of the section.

The Value of Assets

16. The question here is how to value the assets of the company. Is book value sufficient? Should it be market value? In borderline cases, do the directors have a responsibility to have the assets of the company valued? Is a lender protected by relying on a certificate by the directors that in their view the transaction does not constitute a major transaction?

17. Here at least, we do have some judicial guidance. In a recent judgment of the New Zealand Court of Appeal[3] it was stated:

> "*Section 129 is undoubtedly concerned with the market value of the company's assets - value must mean value in the accepted sense of that word, and there is nothing in the context of s129 to read it in any other way. Shareholders who are concerned with any such issues will be fully aware that accounts which have historical cost as a method of showing book value of assets are not holding that out as reflecting market values. Furthermore, if a dispute arises as to the application of s129 to a particular sale, there can be no doubt the enquiry would be to ascertain market value, which would be established from all relevant evidence.*"

18. It was held in that case that while the transaction involved would have been a major transaction if the value of the company's assets was based on book values (historical cost less depreciation), it was clearly not a major transaction if the assets were valued at the time of the transaction by reference to market value. The court did not accept a submission that the company's published financial accounts, made available to shareholders, were conclusive against the directors of the company as to the value of its assets.

C. Conclusion

19. I make no apology for the fact that this paper raises more questions than it answers. The approach one takes to these problems will depend on the interests of one's client. Whether it can be established that there is a need for legislative intervention or clarification will depend on how often problems arise in practice in obtaining approval by special resolution of larger financing facilities, particularly in the case of widely held companies.

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[3] Cudden and Others v Marlborough Electric Limited and Others, 31 March 1999