Australian Government
Corporations and Markets Advisory Committee

MEMBERS' SCHEMES OF ARRANGEMENT

Report

December 2009

Corporations and Markets **Advisory Committee**

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14 December 2009

The Hon Chris Bowen MP
Minister for Financial Services, Superannuation and Corporate Law
Parliament House
CANBERRA ACT 2600

Dear Minister

I am pleased to present a report by the Advisory Committee on *Members' Schemes of Arrangement*.

Yours sincerely

Richard St. John
Convenor

Contents

1 Introduction

This chapter describes the scope of the review and the review process and outlines matters covered in the report.

1.1 Scope of review

Members' schemes of arrangement under Part 5.1 of the Corporations Act are a mechanism for achieving a binding arrangement with shareholders on structural change within a company or a corporate group. They can be used to achieve changes in capital structure, the rights of members or the relationship between corporate entities. They can be tailored to novel or complex corporate changes or be used for group reconstructions.

Members' schemes have also evolved in recent years as a means of achieving changes of corporate control. They are commonly used for this purpose, in non-hostile circumstances, in preference to a takeover bid under Chapter 6 of the Corporations Act. In the period from 1 January 2008 to 1 July 2009, there were 78 takeover bids in relation to listed entities (being 73 off-market and 5 on-market bids), compared with 58 members' schemes.[1] The use of schemes to change corporate control has received judicial and regulatory recognition.

The Advisory Committee was asked by the former Government, in the context of a broader reference, to provide advice on a particular aspect of members' schemes, namely the 'headcount' test for

1 Statistics provided by ASIC. Schemes may be preferred for larger change of control transactions. For instance, according to information provided by Blake Dawson, in the period January 2007 to May 2009, there were 11 members' schemes involving funds over $1.5bn ($30.3bn in total), compared with 5 takeover bids involving funds over $1.5bn ($9.8bn in total).

shareholder approval.[2] The Committee considered that it would be useful to consider this issue in the context of a broader review of whether the members' scheme provisions operate in an effective and appropriate manner, and with appropriate safeguards, to facilitate corporate restructuring.[3] The Committee had in mind the increasing and changing use of members' schemes, including their use as a means to achieve change of corporate control, and the fact that the relevant provisions of the Corporations Act have remained largely unchanged over many years.

While the Committee has previously considered schemes in various contexts,[4] they have not been the subject of a general review.

The report draws comparisons between the use of schemes, bids and share capital reductions to effect a change of control in a company. It discusses a range of issues and considers possible changes to the scheme provisions that would affect change of control schemes. However, the report does not go on to consider the treatment of change of control transactions under Chapters 6 and 6A of the Corporations Act, which, together with the role of the Takeovers Panel, are tailored for bids. While bids are referred to by way of comparison, the focus of this report is on schemes.

1.2 The review process

Discussion paper

CAMAC published a discussion paper in June 2008 and invited comment from interested parties. The paper provided background material on the use of members' schemes for change of control and

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2 In May 2007, the then Parliamentary Secretary to the Treasurer, the Hon. Chris Pearce, MP, referred to the Advisory Committee, amongst other matters, whether the headcount test in a members' scheme, namely that the scheme be approved by a majority in number of members present and voting, should be removed. This reference arose from a submission from the Law Council of Australia, in the context of the then Government's insolvency review, recommending abolition of the headcount test. The other matters in the May 2007 reference are dealt with in the Advisory Committee report *Issues in external administration* (November 2008).

3 The Advisory Committee can initiate its own reviews, as well as respond to matters referred to it by the Government: *ASIC Act* s 148.

4 Schemes have been considered in the CAMAC reports *Compulsory Acquisitions* (1996) paras 5.1-5.14, *Corporate Groups* (2000) Chapter 5 and *Long-tail liabilities: the treatment of unascertained future personal injury claims* (May 2008) Chapter 7.

other corporate reorganizations, analysed the current legal position in Australia and sought to identify a range of issues that have arisen in practice and may benefit from further consideration. The aim was to consider the effectiveness and appropriateness of the current legislative and regulatory approach to the facilitation of corporate restructuring.

Submissions

The Advisory Committee received submissions from:

- Abacus – Australian Mutuals
- Alan Cameron AM
- Allens Arthur Robinson
- Australian Foundation Investment Company Limited
- Australian Institute of Company Directors
- Australian Securities and Investments Commission
- Australian Shareholders' Association
- Claudia Koon Ghee Wee & Marina Nehme
- Computershare Investor Services Pty Limited
- Corrs Chambers Westgarth
- Financial Services Institute of Australasia
- Law Council of Australia
- Minter Ellison, Lawyers
- NSW Law Society Business Law Committee
- RiskMetrics Group.

The Committee was greatly assisted in its consideration of the issues by the information and views provided by those respondents. The Committee thanks them for their contributions.

Reference is made to submissions in the following chapters. The submissions are available on the CAMAC website.

Other sources

In preparing this report, the Advisory Committee has taken into account a range of publications on the scheme provisions, including the work by Tony Damian and Andrew Rich, *Schemes, Takeovers and Himalayan Peaks* (2nd edition, 2009)[5] (hereinafter referred to as Damian & Rich). Reference is made at various places in the report to comments by them and other commentators.

1.3 Terminology

For ease of reference:

- members' schemes are generally referred to as 'schemes'
- takeover bids are referred to as 'bids'
- the term 'change of control' means achieving corporate control by obtaining a majority, or all, of the voting shares of a company
- the term 'shareholders' rather than 'members' is generally used (given that, while ss 411 and 412 refer to members, most schemes concern companies with an issued share capital).

1.4 Outline of report

There was a high level of support in submissions for the retention of members' schemes of arrangement as a flexible and commonly used procedure that can be adapted to the needs of particular companies to achieve various forms of corporate reorganization, including, but not confined to, a change of corporate control.

While the use of schemes has evolved over time, the scheme provisions themselves have remained largely unchanged from their formulation in the 19th Century. The Committee recommends a

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5 T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks: The use of schemes of arrangement to effect change of control transactions* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, University of Sydney) (2nd edition, 2009).

number of legislative changes to improve the operation of the scheme provisions, without changing them fundamentally or reducing their flexibility, while maintaining protections for shareholders and other affected parties.

Chapter 2 describes some of the purposes for which schemes are used and the procedural steps in carrying them out.

Chapter 3 considers a range of factors that may influence a choice between a scheme, a bid, and a reduction of capital, to effect a change of control. The Committee basically adopts a position of neutrality in relation to the use of a scheme or bid in a particular situation. It considers that schemes as well as bids have a legitimate role as means to bring about a change of control. While there is some difference in the protection afforded to shareholders and other parties under schemes compared with bids, the differences are explicable and the Committee does not see a need to reconcile the two approaches.

The discussion in Chapter 3 also sets the context for the consideration in later chapters of various issues and policy options regarding the regulation of schemes.

Chapter 4 discusses a range of issues about the information to be provided to shareholders to assist them in deciding whether to approve a scheme. The Committee recommends a number of measures to make disclosures to shareholders more effective and useful. It also considers appropriate protections for scheme proponents when making disclosures.

Chapter 5 considers possible procedural changes relating to voting by classes of shareholders and whether the headcount voting test should remain. The Committee recommends that courts be given greater power to deal with questions involving class voting. It also recommends removal of the headcount test for companies having a share capital.

Chapter 6 considers whether ASIC should have additional modification powers in relation to schemes and whether the takeover avoidance provision (s 411(17)(a)), which prohibits the court from approving a scheme in certain circumstances, and the role of ASIC in providing a statement to the court (s 411(17)(b)), should be repealed or amended in some manner. The Committee recommends abolition of s 411(17)(a) and supports a continued role for ASIC in providing assistance to the court.

Chapter 7 discusses possible extension of the scheme provisions beyond shareholding interests in corporate entities to accommodate holders of options over unissued shares or convertible notes, as well as managed investment schemes. The chapter also considers whether the scheme provisions should be simplified for mergers within wholly-owned corporate groups or adapted in some way to allow a scheme to be promoted by a third party without the support of the company in question. The Committee recommends a number of measures, including extension of the scheme provisions to managed investment schemes and a simplified procedure for mergers within wholly-owned corporate groups.

Chapter 8 considers various ways to streamline the process for implementing schemes, including those that involve an alteration of the company's constitution or a reduction of share capital. It also considers the transfer of encumbered shares under a scheme. The chapter also deals with the separate procedure under s 414 for restructuring companies and the role of creditors' schemes. The Committee sees no need for change to s 414 and concludes that there is a continuing role for creditors' schemes.

1.5 The Advisory Committee

The Advisory Committee is constituted under the *Australian Securities and Investments Commission Act 2001*. Its functions include, on its own initiative or when requested by the Minister, to provide advice to the Minister about corporations and financial services law and practice.

The members of the Advisory Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their knowledge of, or experience in, business, the administration of companies, financial markets, financial products and financial services, law, economics or accounting.

The members of the Advisory Committee are:

- Richard St John (Convenor)—Special Counsel, Johnson Winter & Slattery, Melbourne

- Zelinda Bafile—Lawyer, Director and former General Counsel and Company Secretary, Home Building Society Ltd, Perth
- Ian Eddie—Professor of Accounting, School of Commerce and Management, Southern Cross University, Tweed Heads
- Belinda Gibson—Commissioner, Australian Securities and Investments Commission
- Alice McCleary—Company Director, Adelaide
- Marian Micalizzi—Chartered Accountant, Brisbane
- Geoffrey Nicoll—Co-Director, National Centre for Corporate Law and Policy Research, University of Canberra
- Ian Ramsay—Professor of Law, University of Melbourne
- Robert Seidler—Partner, Blake Dawson, Sydney
- Greg Vickery AM—Chairman and Partner, Deacons, Brisbane
- Nerolie Withnall—Company Director, Brisbane.

A Legal Committee has been constituted to provide expert legal analysis, assessment and advice to the Advisory Committee in relation to such matters as are referred to it by the Advisory Committee.

The members of the Legal Committee are selected by the Minister, following consultation with the States and Territories, in their personal capacity on the basis of their expertise in corporate law.

The members of the Legal Committee are:

- Nerolie Withnall (Convenor)—Company Director, Brisbane
- Lyn Bennett—Partner, Hunt & Hunt, Darwin
- Elizabeth Boros—Barrister-at-Law, Melbourne
- Damian Egan—Partner, Murdoch Clarke, Hobart
- Jennifer Hill—Professor of Law, University of Sydney

- James Marshall—Partner, Blake Dawson, Sydney
- David Proudman—Partner, Johnson Winter & Slattery, Adelaide
- Simon Stretton—South Australian Crown Solicitor, Adelaide
- Gabrielle Upton—Legal Counsel, Australian Institute of Company Directors, Sydney
- Rachel Webber—Special Counsel, Jackson McDonald, Perth.

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Thaumani Parrino—Office Manager.

2 Outline of scheme provisions

This chapter provides an overview of the use of members' schemes of arrangement and steps in their implementation.

2.1 Legislative history

The provisions requiring shareholder and court approval of corporate reorganization by way of schemes of arrangement have not changed much since their introduction.

Australian legislation was modelled on the provisions introduced in the United Kingdom in the 1860s and 1870s, which originally covered only creditors' schemes, but were expanded in the early 20th century to include members' schemes.[6] Various other European and North American jurisdictions have somewhat comparable merger provisions.[7]

The scheme provisions were adopted into Australian State-based law[8] and were included in the 1961 State Uniform Companies Acts.[9] They were included, without substantive change, in the 1981 national companies and securities legislation.[10] An amendment in 1982 introduced the current form of what may be referred to as the

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6 The key provisions were s 136 of the *Companies Act 1862* (UK) and s 411 of the *Joint Stock Companies Arrangement Act 1870* (UK), which introduced creditors' schemes in the modern form, and s 120 of the *Companies (Consolidation) Act 1908* (UK), which introduced members' schemes. The history and application of the UK scheme provisions, and an outline of other ways of acquiring corporate control under UK law, are set out in Damian & Rich, supra footnote 5, Chapter 12. See also, Justice KE Lindgren of the Federal Court, in 'Private Equity and Section 411 of the Corporations Act 2001 (Cth)' (2008) 26 *Company and Securities Law Journal* 287 at 291-294.

7 See Damian & Rich, supra footnote 5, Chapter 13.

8 *Companies Act 1936* (NSW) s 133, *Companies Act 1958* (Vic) ss 89, 90, *Companies Act 1931* (Qld) s 161, *Companies Act 1934* (SA) s 171, *Companies Act 1943* (WA) s 158, *Companies Act 1959* (Tas) ss 123, 124.

9 Uniform Companies Acts (1961–1962) ss 181–185.

10 *Companies Act 1981* ss 314–319.

takeover avoidance provision[11] (now s 411(17) of the Corporations Act).

The scheme provisions were included, without substantive change other than to permit consolidated meetings in some circumstances, in the Corporations Law,[12] which applied from 1991. Those provisions were carried over into the current Corporations Act in 2001.[13]

In the United Kingdom, the *Companies Act 2006* retains the same general shareholder and court approval requirements for schemes, with some drafting simplification and inclusion of particular provisions for mergers.[14]

2.2 Scope

The scheme provisions in Part 5.1 are facilitative. They provide a voluntary mechanism by which a binding arrangement may be entered into between a company and its shareholders, including an arrangement to change the corporate structure or shareholdings. The scheme provisions are:

> intended to provide machinery (i) for overcoming the impossibility or impracticability of obtaining the individual consent of every member of the class intended to be bound thereby, and (ii) for preventing, in appropriate circumstances, a minority of class members frustrating a beneficial scheme.[15]

A scheme can cover any 'compromise or arrangement' between a company and its shareholders. A compromise involves a settlement

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11 *Companies Act 1981* s 315(21), also found in s 317(5).

12 *Corporations Law* ss 410–415A.

13 ss 410–415. The only change was the deletion of s 415A, which was no longer needed in light of the referral of power by the States.

14 *Companies Act 2006* (UK) ss 895–901 (schemes generally), ss 902–918 (additional provisions for mergers). Damian & Rich, supra footnote 5, at [12.16] outline how various proposed amendments were dealt with in the Parliamentary debates leading up to enactment of the 2006 UK legislation.

15 *Re Norfolk Island and Byron Bay Whaling Co Ltd and the Companies Act* (1969) 90 WN (Pt 1) (NSW) 351 at 354. The facilitative role of the scheme provisions was referred to in *Waltons Bond ACT Pty Ltd v Ampolex Ltd* (1996) 22 ACSR 451 at 452.

of a dispute.[16] An arrangement is not so limited and can bring about changes to the rights and obligations of the company and its shareholders,[17] including:

- corporate reorganization, which may involve a reconstruction or amalgamation of companies. The terms reconstruction and amalgamation do not have strict legal meanings, but refer to the various ways to effect a corporate reorganization within or between companies. An amalgamation involves two or more companies merging or blending their activities, while a reconstruction may involve a company reorganizing its internal shareholding structure or taking over the assets and liabilities of one or more other companies.[18] Corporate reorganizations

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16 *Sneath v Valley Gold Ltd* [1893] 1 Ch 477. A compromise involves some element of accommodation between the parties, rather than one party totally abandoning a claim: *Re NFU Development Trust Ltd* [1973] 1 All ER 135.

17 *Re International Harvester Co of Australia Pty Ltd* [1953] VLR 669 at 672. In *Re Hostworks Group Ltd* [2008] FCA 64 at [26], the Court observed that 'an arrangement may extend to any subject matter which is something which a company is able to agree with its members, and is likened to a contract between a company and its members'.

18 In *Stork ICM Australia Pty Ltd v Stork Food Systems Australasia Pty Ltd* [2006] FCA 1849 at [76]-[78], the Court held that the corporate reorganization was a reconstruction rather than an amalgamation, as there would not be any blending of activities. However, Lindgren J stated that a restrictive interpretation should not be placed on either of the terms amalgamation or reconstruction and that the approach should be 'simply to inquire whether the circumstances of a particular case fall within one or the other or both of the words, without first attempting to delineate their respective boundaries of meaning'.
Companies may effect a reorganization in various ways:
- *merger by absorption*: all or part of the undertaking, property and/or liabilities of a company (the transferor company) are transferred to another existing company (the transferee company). This form of merger may involve a number of transferor companies being absorbed into a transferee company
- *merger into a new company*: all or part of the undertaking, property and/or liabilities of two or more transferor companies are transferred to a new transferee company.

See, for instance, *SGIC Insurance Limited v Insurance Australia Limited* [2004] FCA 1492, *Re Crown Diamonds Nl* [2005] WASC 93 at [10], *pSivida Ltd v New pSivida, Inc* [2008] FCA 627. The scheme in *Great Artesian Oil and Gas Limited* [2008] FCA 997 is an example of a merger through an acquiring company purchasing all the issued shares in another company that it does not already own or control, in consideration for the issue to the other shareholders of the acquired company of new shares in the acquiring company.
In *SGIC Insurance Limited*, the Court held, adopting the reasoning in *Re AGL Sydney Ltd* (1994) 13 ACSR 597, that the merger by absorption could proceed by way of a members' scheme only, notwithstanding that the transfer of the assets and liabilities could affect creditors:

involving reconstructions or amalgamations may take place between related or unrelated companies for various commercial reasons, including to expand a business into new products or markets, to achieve greater influence in a production or distribution process or to obtain economies of scale and thereby reduce overall costs[19]

- de-mutualisation[20] or mergers or other reorganizations for mutual companies[21]
- the de-merger or break-up of a company or a corporate group[22]
- an arrangement to facilitate a change of jurisdiction of incorporation of a company[23]

> the appropriate protection for creditors is that they have the right to appear at the second court hearing in the event that they wish to express concerns as to the appropriate protection for creditors in the light of the transfer of obligations arising from the reconstruction (at [10]).

If the scheme is approved, the court may make various consequential orders under s 413 regarding the transfer of the whole or a part of the undertaking, property or liabilities of the transferor company to ensure that the reorganization is fully and effectively carried out. See, for instance, *Royal Victorian Institute for the Blind Ltd v RBS.RVIB.VAF Ltd* [2004] FCA 735, *Millennium CHPP Pty Ltd v Millennium Coal Pty Ltd* [2009] FCA 1556.

On reconstructions and amalgamations, see further Damian & Rich, supra footnote 5, at [9.2].

19 For instance, in *Solution 6 Holdings Limited* [2004] FCA 1049, the Court observed (at [3]) that 'the rationale for the merger is to be found in the combination of the strengths of the respective complementary businesses of Solution 6 and MYOB and the synergies which will flow from the merger'. Likewise, in *Millennium CHPP Pty Ltd v Millennium Coal Pty Ltd* [2009] FCA 1556, the purpose of the internal corporate group reorganization, involving the transfer of assets and liabilities of each scheme company to another company within the corporate group, was 'to reorganise assets and liabilities of particular projects and operations [of the corporate group] into a logical component structure.'

20 For instance, *Re MBF Australia Ltd* [2008] FCA 428, *Re Manchester Unity Australia Ltd* [2008] FCA 1845, *Re Australian Health Management Group Ltd* [2008] FCA 1868. See further Damian & Rich, supra footnote 5, at [9.6].

21 Abacus - Australian Mutuals, in its submission, pointed out that 'the procedure provided in s 411 for schemes of arrangement is typically the only means for mergers and other important corporate reorganisations [of mutual companies] to be achieved, other than by transfers of business'.

22 See, for instance, *Re National Bank Ltd* [1966] 1 All ER 1006, *Re AMP Ltd* [2003] FCA 1465 and [2003] FCA 1479, *Re Australian Gas Light Co* (2006) 56 ACSR 659 (the proposed de-merger in this case did not go ahead). See further Damian & Rich, supra footnote 5, at [9.4].

23 See further Damian & Rich, supra footnote 5, at [9.5].

- arrangements to bring about a change of control of a company. This can include 'public to private' transactions funded through private equity[24] and 'reverse takeovers'.[25]

The decision to embark upon a scheme rests with the directors of the scheme company. They may act because they support the proposed scheme or otherwise are of the view that shareholders should have the opportunity to consider it.[26] In so doing, directors are subject to various duties, including to exercise care and diligence in the exercise of their powers and to act in good faith in the best interests of the company and for a proper purpose.[27]

2.3 Procedural steps

In theory, any shareholder, as well as the company itself, can propose a scheme.[28] However, the legislation proceeds on the basis that the company in question will undertake the procedural steps to implement a scheme. In practice, scheme proposals are put to the court and to the shareholders by the company, even where the purpose of the scheme is to assist a third party to achieve control of the company.

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24 See further Damian & Rich, supra footnote 5, at [9.7] and Justice KE Lindgren of the Federal Court, in 'Private Equity and Section 411 of the Corporations Act 2001 (Cth)' (2008) 26 *Company and Securities Law Journal* 287 at 288-289.

25 In Regulatory Guide 60 at RG 60.36, ASIC states that 'a scheme results in a reverse takeover if (a) consideration for the members of the company proposing the scheme (the target company) is shares in the offeror company; and (b) the scheme results in a change in control of the offeror company or has a material effect on control of the offeror company'. ASIC has also indicated, in a note to RG 60.37, that it is considering whether further guidance regarding these types of schemes might be provided in light of the decision of the Takeovers Panel in *Re Gloucester Coal Limited 01R* [2009] ATP 9.

26 For instance, where an intending controller will offer a considerable premium to shareholders, but only by way of a scheme.

27 ss 180, 181. In *ASIC v Rich* [2009] NSWSC 1229 at [7267], Austin J referred to the business judgment defence in s 180(2) as available 'to the management decisions involved in propounding a scheme of arrangement for the purposes of acquisition, or for purposes of corporate reconstruction'.

28 Subsection 411(1) refers to an application by the company or other parties, including 'any member' of the company.

2.3.1 Key steps

The key procedural steps in a scheme[29] are:

- preparation by the scheme company of a draft notice convening a meeting of shareholders and an explanatory statement concerning the scheme, to be registered with ASIC.[30] If requested, ASIC will provide a preliminary letter to the company indicating whether it proposes to make submissions to the court, or intervene to oppose the scheme, at the first court hearing[31]

- application by the scheme company to the court to convene a meeting or meetings (if more than one class) of shareholders (the first court hearing).[32] The role of the court at this hearing is to satisfy itself that various 'threshold requirements' have been satisfied (including that the scheme documents provide sufficient disclosure to shareholders as to how the scheme will operate[33]), that ASIC has been given a reasonable opportunity to

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29 A useful overall summary is set out by Emmett J in *Central Pacific Minerals NL* [2002] FCA 239 at [2]-[14].

30 The process for lodgment with ASIC is set out in ASIC Regulatory Guide 60 at RG 60.110-RG 60.113. Section 412 and Corp Regs Schedule 8 Part 3 set out the information to be included in the explanatory statement. This is the responsibility of the scheme company. For instance, s 412(1) states that, where a meeting is convened under s 411, 'the body' (meaning the scheme company) must send certain information to shareholders. The explanatory statement cannot be circulated to shareholders until it has been registered by ASIC: s 412(6). Subsection 1274(8) sets out the criteria for ASIC to consider in determining whether to register a document. ASIC will not register an explanatory statement until it has been approved (or not objected to) by the court under s 411(1) or (1A): ASIC Regulatory Guide 60 at RG 60.12.

31 ASIC Regulatory Guide 60 at RG 60.107 states:

> We [ASIC] recognise, however, that the proponents of a scheme may reasonably wish for an indication of our views before committing to the expense of calling a meeting or printing the scheme documentation. We will therefore provide a letter prior to the first hearing indicating whether we propose to make submissions to the court, or intervene to oppose the scheme, at this hearing. This letter will be in the form set out in Pro Forma 193 *Indication of intent under s 411(17)(b)* (PF 193). We will expressly state in the letter that our position, as indicated, is based on the information provided by the scheme proponents to date and may change as we consider appropriate.
>
> Note: Our preliminary s 411(17) letter will also help proponents satisfy the court that we have had a reasonable opportunity to examine scheme materials and make submissions to the court as required by s 411(2)(b).

32 s 411(1).

33 As observed in *IOR Group Limited* [2009] FCA 1588 at [9]:

examine the proposed scheme documentation and has not raised any objections at this stage,[34] and that there is no reason why the scheme should not receive the approval of the court at the second hearing if the necessary majority of shareholder votes is achieved.[35] In this way, the court has the opportunity to filter out poorly disclosed, unworkable, or unfair schemes.[36] The court may also in appropriate cases vary an earlier order to convene a

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> The way in which the scheme operates must be presented fairly at the meeting. This does not require that every possible argument for and against the proposal be canvassed in the material. In *Fraser v NRMA Holdings Ltd* (1995) 55 FCR 452 at 468, the Full Court observed that the need to give a full and fair account of the scheme "must be tempered by the need to present a document that is intelligible to reasonable members of the class to whom it is directed".

34 See the Note to ASIC Regulatory Guide 60 at RG 60.107, quoted in footnote 31. While the usual practice of ASIC is not to appear at the first court hearing, it may become involved in other ways, such as making comments and suggesting amendments to the scheme booklet: see, for instance, *White Energy Company Limited, in the matter of White Energy Company Limited* [2009] FCA 1218 at [10], *Warwick Resources Limited, in the matter of Warwick Resources Limited* [2009] FCA 1231 at [7].

35 *FT Eastment & Sons Pty Ltd v Metal Roof Decking Supplies Pty Ltd* (1977) 3 ACLR 69 at 72, *Re Sonodyne International Ltd* (1994) 15 ACSR 494 at 497–499, *Re NRMA Ltd* (2000) 33 ACSR 595 at [12]-[26], *Re Hills Motorway Ltd* [2002] NSWSC 897 at [5], *Re Central Pacific Minerals NL* [2002] FCA 239 at [8]-[9], *Re CSR Ltd* (2003) 45 ACSR 34 at [6], *Re Adelaide Bank Limited* [2007] FCA 1582 at [38], *Re Dyno Nobel Limited* [2008] VSC 154 at [15]-[18], *Re Macquarie Communications Infrastructure Group* [2009] NSWSC 487 at [5]-[10], *Re Cytopia Ltd* [2009] VSC 560 at [3].

For instance, in *Excel Coal Limited* [2006] FCA 1240 at [6], the Court noted that:

> [the target company] established a 'Due Diligence Committee' for the purposes of ensuring that the Scheme Booklet complied with all applicable legal requirements, assisting with the drafting of the Scheme Booklet, and conducting an appropriate 'due diligence and verification process' in relation to the Scheme Booklet.

In *Re IXLA Ltd* [2007] VSC 573 at [34], the Court commented:

> Should the scheme meetings be ordered? The court will not ordinarily summon a meeting unless the scheme is of such a nature and cast in such terms that if it achieves a statutory majority at the relevant meetings the court would be likely to approve it on the hearing of an application which is unopposed: *FT Eastment & Sons Pty Ltd v Metal Roof Decking Supplies Pty Ltd.* As to the test of whether the court would be likely to approve the scheme, the relevant question to ask is as follows; could it reasonably be supposed that sensible business people will consider the arrangement to be for the benefit of the class concerned: *Re Sonodyne International Ltd*.

36 For instance, in *Re Foundation Healthcare Ltd* (2002) 42 ACSR 252 at [44], the Court observed that at the first court hearing the usual practice is 'not ordinarily [to] go very far into the question of whether the arrangement is one which warrants the approval of the court' though 'that is not to exclude the possibility that a scheme may appear on its face so blatantly unfair or otherwise inappropriate that it should be stopped in its tracks before going any further'.

scheme meeting,[37] revoke the order for a meeting,[38] or postpone the date of the meeting[39]

- distribution of the scheme documents to shareholders[40] and voting by shareholders at the meeting or meetings.[41] Schemes require approval (of each class) under both a shareholder 'headcount' test (unless dispensed with by the court) and a shareholding 'voted shares' test. The headcount test is a simple majority (50% plus one) of the registered shareholders (or each class of registered shareholders) who vote on the proposed scheme, either in person or by proxy,[42] regardless of the shareholding of each participating shareholder. The voted shares test is a special majority (75%) of the 'votes cast on the

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37 See, for instance, *Equigold NL (No. 2)* [2008] FCA 826, where the Court exercised its powers under s 1319 to amend the notice period for calling the scheme meeting because of a difficulty in complying strictly with the date required for the dispatch of certain documents to members.

38 *CMPS&F Pty Ltd v Crooks Mitchell Ltd* (1997) 76 FCR 366, *Australian Gas Light Company* [2006] FCA 346, *Anzon Energy Limited, in the matter of Anzon Energy Limited (No 2)* [2008] FCA 672. The court can exercise its powers under s 1319 to revoke an earlier order to convene a scheme meeting, for instance, where a precondition to the scheme has not been fulfilled, or the directors of the target company have withdrawn their support for the proposed scheme, and the court is satisfied that the holding of the scheme meeting would lack utility.

39 *In the matter of Lend Lease Primelife Ltd; In the Matter of Lend Lease Village Responsible Entity Ltd* [2009] NSWSC 1340.

40 Under s 412(1), a scheme company is required to send an explanatory memorandum to the relevant shareholders with every notice convening a scheme meeting. These items may be included in a scheme booklet distributed to shareholders, which may also contain an independent expert's report, the draft scheme implementation agreement, a letter from the chairman, and a schedule of frequently asked questions and the relevant answers. The information contained in a scheme booklet may be compiled, assessed and verified by a due diligence committee established by the company: see, for instance, *Felix Resources Limited; In the matter of Felix Resources Limited (No. 3)* [2009] FCA 1483 at [12].
While ASIC does not have the power to amend this requirement, the court may permit the explanatory statement to be distributed to members electronically. For instance, in *Alinta Limited (No 2)* [2007] FCA 1378, the Court approved a variation of the previous court-approved terms of the scheme to allow shareholders to elect to receive notices from the company electronically.

41 The procedure for calling a scheme meeting is the same as calling any general meeting of shareholders under Part 2G.2 of the Corporations Act: *Re Sims Group Ltd* (2005) 55 ACSR 422 at [8]-[10]. In *Lion Nathan Limited, in the matter of Lion Nathan Limited (No. 2)* [2009] FCA 1261 at [8]-[16], Emmett J outlined the method of electronic voting used at the meeting: 'I have described the system in some detail because of its novelty.'

42 s 411(4)(a)(ii)(A). This provision refers to voting by members. Section 231 indicates that persons are members of a company only if their names appear on the register of members.

resolution', for a body with a share capital.[43] For the usual situation of a company with one vote per share, this test means 75% of the shares voting on the resolution[44]

- if approved by shareholders, application by the scheme company to the court to approve the scheme (the second court hearing). At this hearing, the court considers the matters referred to in s 411(17).[45] The court also has a general discretion whether to approve a scheme, over and above being satisfied that the voting and other procedural requirements have been complied with.[46] The court may excuse procedural irregularities where the failure to comply has not caused, and will not cause, substantial injustice to any person.[47] This second hearing provides an opportunity for dissenting shareholders or other interested parties to put forward arguments why approval should not be given. The court can approve or reject a scheme as proposed,[48] approve it with such alterations or conditions as it thinks just,[49]

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43 The 75% voted shares test for members' schemes (s 411(4)(a)(ii)(B)) contrasts with the 75% of the value of the debts and claims test for creditors' schemes (s 411(4)(a)(i)). A headcount test applies to both members' and creditors' schemes.

44 Prior to 1998, a share 'value' test and a headcount test were applied. However, in consequence of the abolition of the par value of shares in 1998, the equivalent of s 411(4)(a)(ii)(B) was amended to replace the reference to the 'value' of shares with the concept of 'votes' attached to shares. The headcount test remained unchanged.

45 The weight of judicial authority is that the court will embark upon an inquiry into the matters the subject of s 411(17) at the second, rather than the first, court hearing: *In the matter of Golden Circle Ltd* [2008] QSC 298.

46 The court is not bound to approve a scheme merely because it has previously made orders at the first hearing to convene the scheme meeting(s) and the requisite majority of shareholders has agreed to the scheme: *Re NRMA Ltd* (2000) 33 ACSR 595 at [37]. The matters about which the court is to be satisfied at this stage of the approval process are set out by Santow J in *Re NRMA Ltd* at [41]. For instance, the court may decline to approve a scheme if the court considers that there has been oppression: *In the matter of Opes Prime Stockbroking Limited* (2009) 73 ACSR 385 at [66]. See further Section 3.5.2 under the heading *general court discretion*.

47 See, for instance, *Ruleburst Holdings Ltd, in the matter of Ruleburst Holdings Ltd (No 2)* [2008] FCA 2010.

48 s 411(4)(b).

49 s 411(6). In *Independent Practitioner Network Ltd (No 2)* [2008] FCA 1593, Lindgren J amended a scheme after it had been voted on, by substituting a subsidiary for the acquirer in the scheme proper, after noting that the change was in a sense fundamental, but satisfying himself that the change in identity of the acquirer would have been immaterial to the shareholders and that the security of the payment arrangements was not diminished. His Honour, at [16]-[17], referred to various authorities on the application of s 411(6), and observed:

or withhold approval until all conditions precedent to the implementation of the scheme have been fulfilled.[50] However, the court does not have the power to be selective as to the shareholders who will be bound by the scheme[51]

- lodgment by the scheme company with ASIC of the court order approving a scheme[52] and annexing that order to the company's constitution where required.[53]

> The circumstances in which the Court may be asked to exercise the power [under s 411(6) to approve a scheme subject to alterations] vary. For example, the purpose may be to overcome minor technical errors or oversights present in the scheme as agreed to by the shareholders (see, for example, *Re H Craig Pty Ltd*); to bring the scheme as agreed to by them into line with the explanatory statement that was sent to them (see, for example, *Re Permanent Trustee Co Ltd*); or to protect creditors (see, for example, *Re Evandale Estates Ltd*). The alterations may be suggested by the plaintiff or by the Court. Apparently, however, the plaintiff would be entitled, if faced with alterations on which the Court insisted but to which it did not agree, to withdraw its application for approval.
>
> At least one thing is clear: the Court will not approve subject to alterations unless it is satisfied that the scheme as proposed to be altered would still have been agreed to by the requisite statutory majorities.

50 *Re Westfield Holdings Ltd* [2004] NSWSC 602 at [9]:

> It is undesirable that the court approve a scheme where there remains unsatisfied some expressed condition precedent to its operation (other than the making of the approval order and lodgment of an office copy of it), particularly where fulfilment of the condition lies in the hands of the scheme company or a controlled entity. Neither the company nor a controlled entity should, except perhaps under some clearly expressed provision specifically brought to members' advance attention, retain any unilateral ability to defeat the scheme after the court has granted its approval. Part of the court's function in exercising the discretion conferred by s 411(4)(b) is to see that the way is clear in all respects, except lodgment of its own order, for effectuation of the proposal to which members have agreed and which the court has otherwise found acceptable.

51 Contrast s 236 of the *Companies Act 1993* (New Zealand), which empowers the court to order that a scheme shall bind the company and 'such other persons or classes of persons as the Court may specify'.

52 s 411(10). Pursuant to s 411(6A), (6B), (6C), introduced in 2007, the court may make various orders, including an order for payment of compensation, where a person has suffered loss or damage as a result of a breach of any provision to which a court-imposed alteration relates, or an order imposing a condition.

An approved scheme binds all shareholders (or the relevant class), including those who voted against the scheme or did not vote. In some cases, a scheme administrator will be appointed to administer the scheme.[54] A scheme may, depending on its terms, involve the compulsory acquisition of shares in the company, including those held by dissident or apathetic shareholders.

2.3.2 Role of the court and ASIC

The role of the court in reviewing scheme documents, approving the calling of scheme meetings and, if otherwise satisfied, granting approval of the scheme is central to the assurance of fairness and due process for shareholders and other affected parties. The involvement of ASIC in the scheme process also protects the interests of shareholders.

In practice, scheme matters are usually initiated by way of ex parte application to the court,[55] with information and guidance being provided by counsel for the scheme proponent, and without the benefit of a contradictor, unless ASIC or some other person wishes to appear or objects to the scheme.

Normally ASIC does not appear in court to make submissions at the first court hearing (unless it already opposes, or has concerns about, the scheme), but, upon request, will provide a letter prior to the first hearing indicating whether it proposes to make submissions to the

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53 s 411(11). The court may exercise its power under s 411(12) to dispense with this annexation requirement where there is no amendment to the constitution (*Re Equinox Resources Ltd* (2004) 49 ACSR 692 at [22] and [23]; *Re Kalgoorlie Lake View Pty Ltd* (2005) 56 ACSR 144 at [30]-[32]; *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at 409, and *Felix Resources Limited; In the matter of Felix Resources Limited (No. 3)* [2009] FCA 1483 at [27]) or the scheme would not otherwise involve modification of any rights of shareholders, creditors or other persons dealing with the company (*Re Rocksoft Ltd* [2006] FCA 1098 at [16], *Re Bolnisi Gold NL (No 2)* [2007] FCA 2078, *Hostworks Group Ltd (No 2)* [2008] FCA 248 at [36]-[37], *Re Lion Selection Ltd* [2009] VSC 546 at [23]-[24]), *Millennium CHPP Pty Ltd v Millennium Coal Pty Ltd* [2009] FCA 1556.

54 See further ASIC Regulatory Guide 60 at RG 60.50-RG 60.53.

55 Only in unusual cases are applications made by opposing parties to appear and be heard at the first court hearing: *Fowler v Lindholm, in the matter of Opes Prime Stockbroking Ltd* [2009] FCAFC 125 at [47] (a case involving a creditors' scheme).

court, or intervene to oppose the scheme, at this hearing.[56] Also, ASIC will not ordinarily appear at the second court hearing if it has no objection to the scheme.[57] ASIC has now indicated that it will appear if:

- we [ASIC] have been asked to assist the court or provide the court with our views—this may occur even if we have no specific issues of our own to raise and do not oppose the scheme

- there are issues that we consider should be raised before the court and the parties may not raise or address those issues adequately

- the proponents have not given us adequate time to consider the scheme documents; or

- we oppose calling the scheme meeting or confirming the scheme.[58]

If ASIC opposes a scheme, it will intervene in a hearing under s 1330.[59]

ASIC has a number of other regulatory options if it considers that the standard of disclosure to, and treatment of, shareholders is not satisfactory or the information provided to them about the proposed compromise or arrangement is otherwise unfair or misleading.[60]

Where schemes are unopposed and proceed on an ex parte basis, the court must rely on the proponents of the scheme to anticipate the disclosure that is properly required and to draw to the court's

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56 See, for instance, *Legrand Australia Pty Ltd v H.P.M. Industries Pty Ltd; in the matter of Legrand Australia Pty Ltd* [2009] FCA 1184 at [11], *eircom Holdings Limited, in the matter of eircom Holdings Limited* [2009] FCA 1418 at [32]. See also ASIC Regulatory Guide 60 at RG 60.107.

57 ASIC Regulatory Guide 60 at RG 60.14, RG 60.99.

58 ASIC Regulatory Guide 60 (December 2009) at RG 60.114.

59 ASIC Regulatory Guide 60 at RG 60.115.

60 ASIC Regulatory Guide 60 at RG 60.116-RG 60.117. Depending on the circumstances, these include taking action for breach of directors' duties, seeking orders under s 232, seeking injunctions or prosecutions for prohibited conduct under Pt 7.10, Div 2, seeking orders under s 1324B, and/or applying to the Takeovers Panel for a declaration of unacceptable conduct.

attention any elements of the scheme that are potentially problematic.[61]

As a practical matter, the bulk and complexity of many scheme documents, and the exigencies of time, add to the burden on the court, which is necessarily reliant on the diligence of counsel for the applicant, at both the first and second hearing, in directing the attention of the court to those features of the proposed scheme that may call for consideration:

> An applicant in this kind of situation, like an applicant ex parte for an injunction, carries the responsibility of bringing to the court's attention all matters that could be considered relevant to the exercise of its discretion.[62]

Likewise:

> A consequence of the fact that applications under s 411 are ex parte is that the Court is more than usually reliant on counsel for the plaintiff to bring to the attention of the Court each and every factor that may be relevant to the Court's exercise of its discretion.[63]

Also, as observed by one judicial commentator:

> The court must ensure that the shareholders will be fully informed, and, to the extent that it can do so, that they will not be deceived. Inevitably, the court relies heavily on legal representatives of the target company who appear before it.[64]

The Advisory Committee returns to this question of assistance to the court later in this report (Section 6.4.2).

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61 *Re Archaean Gold NL* (1997) 23 ACSR 143 at 148.

62 *Re Permanent Trustee Co Ltd* [2002] NSWSC 1177 at [7], per Barrett J. The restructuring of the James Hardie Group in 2001 is a well-known example of where, at the second hearing, the Court was misinformed about material matters. The relevant details are summarised in Section 3.1 of J Hill *Corporate restructuring from Beijing to Sydney: contemporary issues concerning schemes of arrangement in Australia* (2009).

63 *IOR Group Limited* [2009] FCA 1588 at [11].

64 Justice KE Lindgren of the Federal Court in 'Private Equity and Section 411 of the Corporations Act 2001 (Cth)' (2008) 26 *Company and Securities Law Journal* 287 at 303.

3 Change of control through schemes and other means

This chapter compares schemes, bids and reductions of share capital as means of effecting a change of control in a company, to provide background for the issues and policy options for schemes discussed in subsequent chapters.

3.1 Overview

Schemes may be used for a range of purposes, including to effect a change of control within a company or a corporate group. When used to this end, a scheme can be compared with a change of control through a bid or a reduction of share capital.

The key common feature of schemes, bids and reductions of capital is that, once approved (schemes or reductions of capital) or successful (where a bidder attains the compulsory acquisition threshold), they bind all shareholders, including non-participating or dissident shareholders. Depending upon their terms, they can be used to achieve majority or complete control. These statutory arrangements are not subject to the restrictions on share expropriation under the *Gambotto* principles.[65]

Schemes have increasingly been used to achieve changes of control, notwithstanding some moves in recent years to overcome difficulties in achieving complete control through a bid.[66] A similar trend towards use of schemes has developed in the United Kingdom.[67]

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65 *Gambotto v WCP Ltd* (1995) 182 CLR 432, 127 ALR 417. See, for instance, *Re NRMA Ltd* (2000) 33 ACSR 595 at [58]-[59]. See also *Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* (2001) 40 ACSR 221 at [85]-[98], confirming that the *Gambotto* principles do not apply to a reduction of capital under ss 256B–256E.

66 For instance, s 663A permits a bidder to compulsorily acquire any securities that are convertible into the bid class securities, following a successful bid. The definition of 'convertible securities' in s 9 includes options.

67 According to the Director General of the UK Takeover Panel, one third of takeovers in the UK now proceed by way of a scheme: *The City Code on Takeovers and Mergers 2007 Conference* (September 2007).

A buy-back offer may be used as an indirect method of increasing voting power in a company (by the party not accepting the offer, unlike other shareholders).[68] Also, a form of buy-back arrangement may be an element of a scheme.[69] However, buy-backs alone are not often undertaken to achieve a change of control, and are not further considered.

This paper does not consider taxation and other factors outside the Corporations Act that in particular circumstances may influence parties to prefer one procedure to achieve a change of control over another.

3.2 Change of control through schemes

The use of schemes to achieve a change of control has been recognised in case law,[70] official commentary[71] and regulatory practices.[72]

The two most common types of scheme structure that have been employed, with or without additional corporate reorganization, to effect a change of control are:

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68 Buy-backs are regulated under ss 257A–257J.

69 *Re Village Roadshow Ltd* (2003) 48 ACSR 167.

70 For instance, in *Re Archaean Gold NL* (1997) 23 ACSR 143 at 147, the Court observed that schemes of arrangement 'have increasingly been allowed to intrude upon the traditional statutory regime for conventional takeovers'. In *MIM Holdings Limited* (2003) 45 ACSR 554 at 557, the Court observed, in rejecting a submission that the proposed acquisition through a members' scheme should be only by way of a takeover bid, that 'the Corporations Act in its Ch 5 provisions [schemes] offers a true alternative to the way in which acquisitions may occur'. The *MIM* case involved a simple cash for shares transfer, similar in this respect to acquisitions under a bid. See also *Re Ranger Minerals Ltd* (2002) 42 ACSR 582 at [26]-[31], *Re International Goldfields Ltd* (2003) 21 ACLC 1199 at [23]-[28].
In *Re Coles Group Ltd (No 2)* [2007] VSC 523 at [22], the Court commented that:

> Many transactions which could be carried out under Chapter 6 [the bid provisions] are carried out by a scheme of arrangement under Chapter 5. The legislation provides a choice, and it is neutral as to the choice which is made. Thus, a corporation is entitled to choose a scheme of arrangement over Chapter 6 if it wishes.

71 Corporate Law Economic Reform Program (CLERP)—Proposals for Reform, Paper No 4, *Takeovers—Corporate control: a better environment for productive investment* (1997) at 5.2.

72 ASIC Regulatory Guide 60 Section B. In *Re Colonial First State Property Trust Group (No 1)* (2002) 43 ACSR 143 at [71] and [80], the Takeovers Panel referred to schemes as an alternative to a takeover bid in achieving a change of corporate control.

- *cancellation schemes*: whereby shares, other than those held by the intending controller, are cancelled pursuant to a capital reduction, with shareholders being paid out, and/or being allotted shares in another company.[73] A scheme that has a capital reduction as one of its elements must also comply with the capital reduction provisions[74]
- *transfer schemes:* all the shares in the company are transferred to the intending controller pursuant to the terms of the scheme (with shareholders being paid out or being allotted shares in another company).[75]

In practice, transfer schemes are now more common than cancellation schemes, given the difficulties with the approval requirements for a cancellation scheme under the selective capital reduction provisions (see Section 3.6).

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73 Examples of various types of schemes involving a share cancellation are found in *Re The Bank of Adelaide* (1979) 4 ACLR 393, *Re Wallace Dairy Co Ltd* [1980] VR 588, *Re ACM Gold Ltd* (1992) 7 ACSR 231, *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219, *Re Stockbridge Ltd* (1993) 9 ACSR 637, *Re Advance Bank Australia Ltd* (1996) 22 ACSR 476, (1997) 22 ACSR 513, *Re CMPS & F Pty Ltd* (1997) 24 ACSR 736, *Re Matine Ltd* (1998) 28 ACSR 268.

74 *Re Cooper, Cooper v Johnson Ltd* [1902] WN 199. See also *Re Advance Bank Australia Ltd* (1997) 22 ACSR 513.

75 There are many examples of share transfer schemes, including *Re Victorian Grain Services Ltd* (2000) 35 ACSR 198, *Re Permanent Trustee Co Ltd* (2002) 43 ACSR 601, *Re MIM Holdings Ltd* (2003) 45 ACSR 554, *Re United Energy Ltd* [2003] VSC 266, *Re International Goldfields Ltd* [2004] WASC 112, *Re Brambles Industries Ltd* (2006) 59 ACSR 501, *Alinta Ltd (No 3)* [2007] FCA 1416, *Investa Properties Ltd* [2007] FCA 1104, *Re Panbio Ltd (No 2)* [2007] FCA 2101, *Re Mincom Ltd (No 3)* (2007) 25 ACLC 1322, *Re APN News & Media Ltd* (2007) 62 ACSR 400, *Re Hostworks Group Ltd* [2008] FCA 64 and [2008] FCA 248. It may also be necessary to send shareholders a prospectus where a capital reduction also involves issuing them with shares in another company: ASIC Regulatory Guide 188.

One issue with transfer schemes concerns the interests of any holder of security over the transferred shares. This issue is discussed at Sections 8.4 and 8.7.4. See further HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.071] under the heading *The acquisition of encumbered shares.*

3.3 Choosing between a scheme and a bid

3.3.1 Similarities and differences

Similarities

In some respects, schemes and bids intended to achieve a change of control are subject to similar requirements, albeit through different regulatory processes.

For instance, bids are subject to detailed initial and ongoing legislative disclosure requirements.[76] Schemes are subject to somewhat less prescriptive disclosure obligations,[77] though this is balanced in practice by the view of the court that:

> schemes of arrangement frequently are but an alternative means to effectuate a takeover. … That entails no lesser level of disclosure [under a scheme] than in a conventional takeover.[78]

ASIC takes a similar position in regard to comparable levels of disclosure.[79]

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76 Part 6.5 Divisions 2–4.

77 ss 411(3), 412, Corp Reg 5.1.01 and Corp Regs Schedule 8 Part 3.

78 *Re NRMA Ltd* (2000) 33 ACSR 595 at [16]. Also, in *Re Archaean Gold NL* (1997) 23 ACSR 143 at 147, the Court observed that schemes of arrangement 'have increasingly been allowed to intrude upon the traditional statutory regime for conventional takeovers' and that in consequence 'courts approving schemes of arrangement have to be vigilant to ensure proper safeguards and disclosure operate, where appropriate adopting analogous safeguards to those applicable to conventional takeovers, though necessarily adapted to the particular situation'.
In *Re Capel Finance Ltd* (2005) 52 ACSR 601 at [7], the Court held that a company embarking on a scheme that was analogous to an off-market takeover bid should be required to make detailed disclosure in the explanatory material about the availability and source of the necessary cash in the manner required by s 636(1)(f) (the bid provision).
Subsection 412(1), Corp Reg 5.1.01 and Corp Regs Schedule 8 Part 3 refer to certain information and documents that must be included in the explanatory statement for particular schemes. Some of these requirements are the same as for a bidder's statement. However, there is not an exact equivalence between the disclosure requirements under schemes and bids. For instance, Justice KE Lindgren of the Federal Court, in his paper 'Private Equity and Section 411 of the Corporations Act 2001 (Cth)' (2008) 26 *Company and Securities Law Journal* 287 points out that the likely effect of a change of control on the workforce of a target company has to be disclosed under a bid (s 636(1)(c)(iii)), but not under a scheme.

79 ASIC Regulatory Guide 60 at RG 60.8-RG 60.10 and RG 60.18.

Individual directors of target boards have comparable disclosure obligations for bids and schemes, though in this respect the scheme disclosure provisions are somewhat more prescriptive than the bid provisions.[80] Also, issues related to duties of directors of target companies, including how to respond to any competing change of control proposal, and possible conflicts of interest within target boards and management, can arise in any form of change of control transaction.[81]

Differences

In theory, any shareholder, as well as the company itself, can propose a scheme to effect a change of control.[82] However, in practice, scheme proposals invariably are put to the court, and to the shareholders, by the company.[83] Directors may agree to initiate a

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80 Specific disclosure obligations for directors of the company the subject of the proposed scheme are set out in Corp Regs Schedule 8 Part 3, including rules 8301, 8302 and 8310. They cover directors' recommendations to shareholders, intentions with regard to their own shares and any benefits they might receive for loss of office if the bid or scheme succeeds. These are in addition to the general disclosure requirements under ss 412(1) and 411(3)(b).

For bids, general, as well as some specific, disclosure obligations are set out in s 636.

ASIC Regulatory Guide 60 at RG 60.9 states, in relation to schemes, that:

> We will also consider the disclosure principles in s 602 and the disclosure obligations in s 636 when determining whether shareholders are adequately informed and protected.

Also, in RG 60.21, ASIC states that:

> Consistent with the court's approach, we will have regard to the principles in s 602 and the disclosure requirements in s 636, as well as the disclosure obligations under reg 5.1.01 and Sch 8 of the Corporations Regulations, when considering an acquisition under a scheme of arrangement that is capable, in whole or part, of being conducted under a takeover bid.

81 Many of these issues are discussed in RP Austin & AF Tuch (eds), *Private Equity and Corporate Control Transactions* (Ross Parsons Centre of Commercial, Corporate and Taxation Law) Monograph 3 (2007) and in the paper by N Young QC, *Conflicts of Interest in the Context of Private Equity Transactions* (Law Council of Australia Corporations Workshop, July 2007). See also the Takeovers Panel Guidance Note 19, *Insider Participation in Control Transactions.*

82 s 411(1).

83 As pointed out by Justice KE Lindgren of the Federal Court, in 'Private Equity and Section 411 of the Corporations Act 2001 (Cth)' (2008) 26 *Company and Securities Law Journal* 287:

> The bidder is not a party to the arrangement and the Court's approval of the scheme does not render it binding on the bidder. What binds the bidder is the antecedent merger implementation deed or agreement between the bidder and the target company.

Also:

scheme because they either support the proposed change of control or, for other reasons, consider that shareholders should have the opportunity to consider it.[84] Proposals for a change of control that are opposed by the company invariably proceed by way of a hostile bid, not a scheme. The fiduciary duties that directors owe to a company will be very much in point when they put forward a scheme proposal for consideration by shareholders. This is particularly the case where a scheme may, for instance, reduce the likelihood of an auction developing for corporate control.[85]

In contrast, a bid is conducted by the intending controller, with the target company and its directors having various statutory obligations to provide information to shareholders in response to the bid.[86] The directors of the target company owe fiduciary duties, but may not be as closely involved with assisting the bid process as under a scheme.

Many of the other differences between schemes and bids are discussed in the following sections of this chapter that compare the

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It should be noted that the bidder does not have standing under s 411, although it may be granted leave to be heard without becoming a party pursuant to r 2.13(1)(c) of the harmonised *Corporations Rules*, such as the *Federal Court (Corporations) Rules 2000*.

84 For instance, an intending controller may indicate to directors that it is prepared to pay a significant premium to shareholders for their shares, but only if the proposed change of control proceeds by way of a scheme rather than a bid.

85 Directors of a target company can encourage, or at least make provision for, the emergence of a competing offer by providing in the scheme documents that they recommend the scheme to shareholders 'in the absence of a superior proposal'.
An auction for control can develop by the emergence of either a rival bid or a rival scheme.
As outlined in *Re Citect Corporation Ltd* (2006) 56 ACSR 663 at [4] ff, the Court in that instance approved various adjustments to the terms of a proposed scheme after the first court hearing but before the shareholders' meeting. Those adjustments, including to increase the consideration offered to shareholders, were sought in response to the emergence of a rival takeover bid.
In *Anzon Australia Limited* [2008] FCA 309 at [4], the Court noted that following an earlier first court hearing for a proposed scheme (*Anzon Energy Limited* [2007] FCA 2080), another party also proposed a scheme, with a superior offer to shareholders, whereupon the directors withdrew their support for the first scheme in favour of supporting the subsequent scheme.
A Colla, 'Scheme warfare: navigating contests for control in friendly takeover schemes' (2008) 26 *Company and Securities Law Journal* 191 discusses some of the factors that may create an auction or rival bid environment where a scheme is proposed, and also outlines some of the strategies available to the various interested parties. The article 'highlights the increasingly complicated landscape that bidders, targets and their advisers need to navigate to execute successfully a friendly takeover scheme' (at 198).

86 Part 6.5 Divisions 3 and 4—*The Target's response*.

benefits, and consequences, of seeking a change of control through a scheme or a bid.

3.3.2 Benefits of a scheme

Parties are likely to weigh various considerations in deciding whether to proceed by way of a scheme or a bid to achieve a change of control where that option is open.[87]

Factors that might incline an intending controller to proceed by way of a scheme rather than a bid include:

- ***dealing with more complex structures.*** A scheme, by itself or in combination with some other statutory procedure,[88] may be preferable to a bid where the proposed transaction involves some corporate restructuring in addition to the changes in shareholding control. A scheme can also be part of a wider arrangement that includes third parties[89]

- ***absence of some restrictions.*** The rules governing bids impose various constraints on the terms of the bid, including in regard to types of conditions and collateral benefits that may be included. There are no equivalent specific restrictions under the scheme provisions, though the court could take such matters into account in determining whether to approve a scheme. These matters are discussed further below (Section 3.4)

- ***certainty within a predictable time frame.*** A scheme will either be approved or be rejected outright by shareholders at one or

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87 Some of the differences between schemes and bids that are discussed in this chapter are also included in the table set out in *Re Colonial First State Property Trust Group (No 1)* (2002) 43 ACSR 143 at [84].

88 In *Re Glendale Land Development Ltd (in liq)* (1982) 7 ACLR 171, the Court held that a scheme cannot provide a method for altering a company's constitution that is inconsistent with the legislative provisions governing this alteration. Compliance with both sets of requirements was necessary.
In *Australian Securities Commission v Marlborough Gold Mines Ltd* (1993) 10 ACSR 230 at 237–238, the High Court ruled that the scheme provisions could not be used to change the status of a company contrary to the specific provisions dealing with this change. Compliance with both sets of requirements was necessary.

89 A court may decline to approve a scheme unless all relevant third parties to a wider arrangement, of which the scheme is an element, have contractually agreed to be bound to the arrangement: *Re Glendale Land Development Ltd (in liq)* (1982) 7 ACLR 171, *Re Advance Bank Australia Ltd* (1996) 22 ACSR 476. See also ASIC Regulatory Guide 60 at RG 60.46-RG 60.49.

more scheme meetings. This provides financiers and other interested parties with some certainty concerning timing and outcome of the proposal, subject to approval by the court.[90]

In comparison, there can be a greater level of uncertainty, for an extended period, about whether a takeover bid (even if supported by the target company) will receive the necessary level of acceptances to succeed. A bidder may choose to keep the offer open for up to a year, provided the bidder meets the requirements for extending the bid.[91] A bidder wishing to achieve an 'all or nothing' outcome can limit the period of the bid and/or employ minimum acceptance conditions. However, a confined period for the bid may reduce its chances of success. Also, minimum acceptance conditions can sometimes work against the success of a bid (given the reluctance or inability of some offerees to accept conditional bids), while a bidder who lifts conditions runs the risk of having to pay for acceptances, but finishing with less than the level of entitlement needed to achieve complete control (where that is the goal)

- ***lower approval threshold for a scheme than for a bid.*** A scheme to effect a full change of control requires the approval of a simple majority of the shareholders who vote on the scheme, as well as 75% of the shares voted, whereas a bidder can only achieve complete control if the compulsory acquisition threshold (at least 90% entitlement) is achieved. However, the approval mechanisms for schemes and bids vary in a number of other significant ways, with schemes having various protective features for shareholders not found in bids. These matters are further discussed below (Section 3.5).

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90 In *Ray Brooks Pty Ltd v New South Wales Grains Board* (2002) 41 ACSR 631 at [17], the Court observed that:

> The great attraction of the scheme of arrangement as a procedure for corporate reconstruction flows from the perception that the court's order, binding all relevant parties including dissentients, is final, subject to appeal.

91 s 624(1)(b).

3.3.3 Benefits of a bid

Factors that might incline an intending controller to proceed by way of a bid rather than a scheme include:

- ***flexibility in adjusting the terms.*** A bidder may choose to extend or vary an offer during the course of the bid, for instance to increase the consideration or lift one or more conditions, to make it more attractive to offeree shareholders.[92] By contrast, a scheme promoter cannot without further court approval alter the terms of a scheme that has been approved by the court, at its first hearing, to go to shareholders, though approval may be given, for instance, to correct formal defects in the documentation or otherwise to assist the decision-making process,[93] or in response to the emergence of a rival bidder or changes to the consideration to be offered.[94] Also, the court has a discretion to approve a scheme that has been altered after shareholder approval[95]

92 B Jolly in his paper 'Moving to 100% ownership after a private equity bid' in RP Austin & AF Tuch (eds), *Private Equity and Corporate Control Transactions* (Ross Parsons Centre of Commercial, Corporate and Taxation Law) Monograph 3 (2007) commented, at 71–72, that his review of takeover bids since 1998 indicated that bidders who lifted their 90% minimum acceptance condition materially improved their prospect of a successful bid. The author also pointed out that lifting that condition can place pressure on institutional shareholders to make a final determination whether to accept or reject the bid.

93 For instance, in *Alinta Limited (No 2)* [2007] FCA 1378, the Court approved a variation of the previously court-approved terms of the scheme to allow shareholders to elect to receive notices from the company electronically.

94 See, for instance, *Re Citect Corporation Ltd* (2006) 56 ACSR 663 at [4] ff, which outlines a series of changes to the original terms of the scheme proposal (to increase the consideration), the information provided to shareholders (through a supplementary explanatory booklet) and the timing of the shareholders' meeting, which were approved by the Court, on various occasions, after the first court hearing but prior to the shareholders' meeting. These changes were sought by the scheme company in response to the emergence of a competing takeover bid after the first court hearing. See also *Excel Coal Limited* [2006] FCA 1383.

95 In *Re Matine Ltd* (1998) 28 ACSR 268 at 284, the Court commented that in considering whether to exercise a discretion under s 411(6) to approve a scheme that has been altered after shareholder approval:

> the court would obviously have regard to whether the proposed variation was so novel or substantial as to take the varied scheme beyond the reasonable contemplation of shareholders at the time they agreed to it.

Also, in the context of s 411(6), the Court in *Re Investorinfo Limited* [2005] FCA 1848 at [7], observed that:

- ***independent expert's report.*** The scheme company must provide shareholders with an independent expert's report on whether a proposed scheme is in the best interests of the shareholders where the intending controller has an entitlement to at least 30% of the company's shares or the intending controller and the scheme company have a common director.[96] A similar obligation applies to bids.[97] However, there is also an expectation that shareholders of a scheme company should receive an expert's report in other circumstances.[98] There does not appear to be a comparable expectation with bids

- ***purpose and comparable protections tests.*** The court may not approve a scheme unless satisfied either that the scheme is not for the purpose of avoiding the bid provisions[99] or that ASIC has provided a 'no objection' statement.[100] The court does not have to be satisfied on both matters.[101] These matters are further

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> If the alteration is of a minor kind which does not really affect the details of the scheme, then the court has power to approve the scheme as amended. … The discretion may be exercised where the amendment improves the smooth working of the scheme without affecting its substance.

96 Corp Regs Schedule 8, Part 3, rules 8303 and 8306. ASIC Regulatory Guide 60 at RG 60.79 indicates that, in the case of an internal corporate group reconstruction, ASIC will normally waive compliance with the requirement for an independent expert's report if no person other than a member company of the group will be required to vote on the scheme.

97 s 640.

98 ASIC Regulatory Guide 60 at RG 60.81-RG 60.83 recommends an independent expert's report in any scheme to remove minority shareholders.
Damian & Rich, supra footnote 5, at [5.7.1] set out various circumstances where directors may not consider it appropriate or necessary to commission an expert's report, including if the premium offered is so generous as to render the scheme clearly fair and reasonable or in the best interests of the shareholders.

99 s 411(17)(a).

100 s 411(17)(b).

101 As summed up in *Re Coles Group Ltd (No 2)* [2007] VSC 523 at [33], adopted at [80]:

> Sub-section 411(17) … imposes a burden on the proponent of a scheme, which is to be discharged … by establishing one or other of the matters in paras 411(17)(a) and (b).
> Failing that, the court must not approve the scheme.
> The two limbs of sub-s 411(17) are true alternatives.
> The proponents have the option to rely on a written statement from ASIC under para 411(17)(b) or satisfying the court that the arrangement has not been proposed for the proscribed purpose [to avoid the operation of any of the provisions in Chapter 6 of the Act].
> Where ASIC provides such a statement, the proponents are relieved of the burden imposed by para 411(17)(a) and the court may, but not must, approve the scheme.

discussed below (Section 3.4.2). There is no equivalent 'no objection' procedure with bids

- ***other functions of the regulator.*** ASIC has an active review function with schemes. It reviews the scheme documentation[102] and raises any disclosure or other concerns with the scheme proponents and, where appropriate, with the court.[103] ASIC has also identified various disclosure and other matters, including fair consideration and the provision of an independent expert's report, which it will take into account in considering a scheme to remove minority shareholders.[104] ASIC has no corresponding review function with a bid

- ***role of the court.*** The court has a broad supervisory role in relation to schemes, reflected in the requirement that a scheme, even when approved by shareholders, requires court approval before it can be implemented. The court may grant approval

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> In the absence of a written statement from ASIC under para 411(17)(b), it is for the proponents of the scheme to establish to the court's satisfaction the absence of the purposes proscribed by para 411(17)(a).
> The matters the subject of para 411(17)(a) may (but need not) be taken into account by the court, in an appropriate case, in the exercise of the discretion conferred by sub-s 411(4) of the Act.
> The closing words of sub-s 411(17) serve to clarify that the court's discretion to approve the scheme is not affected by the provision of a written statement by ASIC under para 411(17)(b).

102 Subsection 412(6) requires the explanatory statement in a members' scheme to be registered with ASIC before distribution to members. ASIC is not to register a statement unless it appears to comply with the legislation and 'ASIC is of the opinion that the statement does not contain any matter that is false in a material particular or materially misleading in the form or context in which it appears': s 412(8). ASIC must be given a reasonable opportunity to examine the documents and make any submissions to the court: s 412(7). The court must be satisfied that that these statutory requirements have been met: *Re NRMA Ltd* (2000) 33 ACSR 595 at [26], *Re Australian Gas Light Co* (2006) 56 ACSR 659. See also ASIC Regulatory Guide 60 at RG 60.5, RG 60.7 and Section C.

103 ASIC Regulatory Guide 60 at RG 60.4 states that the role of ASIC is to assist the court by:

> (a) reviewing the content of scheme documents;
> (b) reviewing the nature and function of the scheme;
> (c) representing the interests of investors and creditors (where in many cases we may be the only party before the court other than the applicant);
> (d) helping to ensure that all matters that are relevant to the court's decision are properly brought to the court's attention before it orders meetings or before it confirms a scheme; and
> (e) registering scheme documents.

104 ASIC Regulatory Guide 60 at RG 60.68-RG 60.73 and RG 60.81-RG 60.83.

with or without amendments or conditions[105] (see further below).

There is no equivalent level of court supervision of a bid. Instead, various parties, including ASIC and any person whose interests are affected by a bid, may apply to the Takeovers Panel for a declaration of unacceptable circumstances.[106] The Panel may refer to the court a question of law arising in any proceedings before it.[107] In other circumstances, only a limited class of persons, including ASIC, may commence court proceedings in relation to a bid, or proposed bid, before the end of the bid period.[108]

3.4 Comparison of scheme and bid protective provisions

Bids and schemes employ different mechanisms to protect the interests of affected shareholders.

3.4.1 Bids

Bids are regulated by reference to general shareholder protective objectives, known as the Eggleston principles.[109] These principles, set out in s 602, seek to ensure that the acquisition of control over the voting shares in a listed or larger unlisted company (or the voting interests in a listed managed investment scheme) takes place in an efficient, competitive and informed market. They provide that the shareholders of the target entity, and the directors of the entity, should:

- know the identity of the bidder
- be given enough information to enable them to assess the merits of the bid

105 s 411(4)(b) (the approval power) and s 411(6) (the variation power).
106 s 657C.
107 s 659A.
108 s 659B.
109 In 1967, the Standing Committee of Attorneys General appointed a committee under the chairmanship of Sir Richard Eggleston to inquire into and report on the extent of protection given to the investing public by the uniform Companies Acts. Among the recommendations of the committee was a statement of principles to protect shareholders of a target company in a takeover.

- have a reasonable time to consider the bid

and that:

- the shareholders have a reasonable and equal opportunity to participate in any benefits accruing to the shareholders through the bid.

In addition to the Eggleston principles, there are various complementary 'equality of opportunity' rules and restrictions on bids, including that:

- an off-market bid must be an offer to buy all the securities in the bid class or a specified proportion of the securities of each holder in that bid class[110]
- the terms of all the offers in an off-market bid must be the same[111]
- the consideration offered under the bid must equal or exceed the maximum consideration paid by the bidder, or an associate, for the bid class securities in the four months prior to the bid[112]
- the bidder, or associate, must not enter into escalation agreements[113]
- the bidder, or an associate, must not offer collateral benefits[114]
- the consideration in an off-market bid must automatically be varied to reflect any higher cash price paid by the bidder outside the bid during the bid period[115]
- the bidder must not include discriminatory conditions in the bid.[116]

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[110] s 618.
[111] s 619. Some exceptions are permitted under s 619(2), (3).
[112] s 621(3).
[113] s 622.
[114] s 623.
[115] s 651A.
[116] s 627.

In deciding whether to exercise its powers to exempt or modify bid requirements in a particular case, ASIC must have regard to the Eggleston principles in s 602.[117]

Likewise, the Takeovers Panel, in considering whether to exercise its powers to make a declaration of unacceptable circumstances, must have regard to various factors, including the Eggleston principles in s 602.[118] Any person whose interests are affected by a bid may apply to the Takeovers Panel for a declaration of unacceptable circumstances or a relevant consequential remedial or other order.[119] There are no restrictions on the number of affected persons who can apply to the Panel in relation to a particular bid or the number of times they can apply. Applicants generally pay their own costs in making an application, though they may obtain a costs order in their favour if the Panel makes a declaration of unacceptable circumstances.[120]

3.4.2 Schemes

There is no statutory equivalent in the scheme provisions of the Eggleston principles in s 602, the disclosure requirements in s 636 or the additional 'equality of opportunity' rules that apply to bids (as set out in section 3.4.1).[121] However, ASIC and the court adopt various approaches to protect the interests of shareholders.

ASIC will take into account the principles underlying ss 602 and 636 when considering an acquisition under a scheme that is capable, in whole or part, of being conducted under a takeover bid.[122] ASIC also takes the view that:

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117 s 655A(2).
118 s 657A(3)(a)(i).
119 s 657C(2).
120 s 657D(2)(d).
121 For instance, A Colla, 'Scheme warfare: navigating contests for control in friendly takeover schemes' (2008) 26 *Company and Securities Law Journal* 191 at 194 points out that the 2007 Coles/Wesfarmers scheme included a share agreement that had characteristics resembling an escalation agreement which, in a bid, would be prohibited under s 622.
122 ASIC Regulatory Guide 60 at Section B. See also RG 60.66-RG 60.67 regarding specific disclosure requirements for a scrip takeover type scheme.

> the explanatory statement of a scheme should state clearly and prominently the comparative advantages and disadvantages of proceeding with or rejecting the scheme.[123]

In the same vein, in exercising its general powers over schemes, a court can consider, in addition to other factors (discussed in Section 3.5.2 under the heading *general court discretion*), various matters particularly relevant to the interests of shareholders.

Lock-up devices

The court can consider whether to approve a change of control scheme that contains 'lock-up' devices. These devices, which are common in change of control schemes, include:

- 'break fees', being a fee payable by the scheme company to the intending controller to reimburse it for due diligence, transaction and opportunity costs if, in certain circumstances, the scheme does not proceed

- exclusivity provisions, such as 'no-talk' and 'no-shop' arrangements, being a promise by the directors of the scheme company not to engage in discussions or negotiations with a third party with a view to soliciting a competing acquisition proposal.

These arrangements, in some circumstances, could coerce shareholders into agreeing to a scheme or have an anti-competitive effect by reducing the possibility of an auction for control. The courts recognise that break fees are acceptable, provided they are reasonable and do not have a coercive effect on shareholders,[124] while exclusivity provisions may be appropriate in particular situations, provided that they are for no more than a reasonable period, are capable of precise ascertainment, do not inhibit due

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123 ASIC Regulatory Guide 60 at RG 60.56.

124 For instance, in *Re SFE Corporation Ltd* [2006] FCA 670 at [7], the Court indicated that it would only be inclined to refrain from ordering a meeting if the amount of the break fee was such that it could influence voting at the meeting or if there were some other unusual circumstances. In *Re APN News & Media Ltd* (2007) 62 ACSR 400 at [52], Lindgren J said that the relevant questions, which were related, were whether the break fee was likely to coerce shareholders into agreeing to the scheme or to deter companies from mounting a competing offer. See also the outline of other judicial decisions on break fees in footnote 125.

discharge of directors' duties and are given adequate prominence in the materials sent to shareholders.[125]

[125] *Re Arthur Yates & Co Ltd* (2001) 36 ACSR 758 at [9].
See also *Re SFE Corporation Ltd* [2006] FCA 670 at [6]-[7] ('break fees'), *Re APN News & Media Ltd* (2007) 62 ACSR 400 at [25]-[35] ('no-shop' provision) and [36]-[55] ('break fee' provision), *Re Hostworks Group Ltd* [2008] FCA 64 at [33]-[37] ('no-talk' provision) and [38]-[40] ('break fee' provision), *Investa Properties Ltd* [2007] FCA 1104 at [31]-[35], *Re Lonsdale Financial Group Ltd* [2007] VSC 394 at [48]-[54], *Macquarie Private Capital A Ltd* [2008] NSWSC 323 at [18]-[21], *Re Dyno Nobel Limited* [2008] VSC 154 at [26], *White Energy Company Limited, in the matter of White Energy Company Limited* [2009] FCA 1218 at [19]-[24] ('break fees'), *Sino Gold Mining Limited, in the matter of Sino Gold Mining Limited* [2009] FCA 1277 at [20]-[25] ('no-shop' and 'no-talk' provisions) and [26]-[28] ('break fee'), *eircom Holdings Limited, in the matter of eircom Holdings Limited* [2009] FCA 1418 at [26]-[28] ('no-shop' and 'no-talk' provisions).
In *Re Bolnisi Gold NL (No 2)* [2007] FCA 2078 at [9]-[39], the Court discussed in detail overseas case law and Takeovers Panel decisions on break fees, including the distinction between a break fee payable for cause and a break fee payable simply if the shareholders vote against the proposal (a 'naked no-vote' provision). The test adopted by the Court, on whether to permit a 'naked no-vote' break fee provision was whether the fee 'was so large as to be likely to coerce shareholders into agreeing to the scheme, rather than assessing the offer on its merits' (at [12]).
Anzon Australia Limited [2008] FCA 309 at [6] is an example of a break fee being paid to an intending controller under a scheme, where the directors withdrew their support for that scheme in favour of a subsequent scheme with a superior offer to shareholders. *Healthscope Limited v Symbion Health Limited* [2009] NSWCA 191 is an instance of disputation on the meaning of a break fee clause. The Court of Appeal held, on its interpretation of the clause, that the break fee was payable only if a meeting of shareholders was held, which did not occur in this case.
In *Idameneo (No 123) Pty Ltd v Symbion Health Limited* [2007] FCA 1832, at [113] ff, the Court ruled that a complainant has the onus to establish that the directors of the target board were in breach of their duties in agreeing to the terms of a break fee, which were to be considered in the context of the overall proposal, not in isolation.
In *People Telecom Limited, in the matter of People Telecom Limited* [2009] FCA 180, the Court, in approving a break fee in excess of the 1% guidelines referred to in the Takeovers Panel Guidance Note 7 *Lock-Up Devices*, observed (at [4]) that:

> Importantly, the break fee is not payable if the proposed scheme is not approved by the shareholders, thus it cannot be said to be a matter which could influence voting at the scheme meeting: see *Re SFE Corporation Ltd* [2006] FCA 670 per Gyles J at [6]-[7]; see also *Re APN News & Media Ltd* [2007] FCA 770; (2007) 62 ACSR 400 at [43].

In *eircom Holdings Limited, in the matter of eircom Holdings Limited* [2009] FCA 1418, the Court approved a break fee of nearly twice the "1% of the equity value of the target", for various reasons set out at [41]-[62], noting, at [48], that the circumstances were unusual and that the break fee did not have an anti-competitive or coercive effect. In *Re Cytopia Ltd* [2009] VSC 560 at [12]-[18], the Court set out reasons why it should not refrain from calling a meeting of shareholders, even where the break fee in the proposed scheme represented 4.57% of the equity value of the company.

Performance risk and other matters

The court may need to be satisfied that the directors of the scheme company have subjected the proposed scheme to due diligence.[126]

The court may also need to be satisfied that change of control, or other, schemes that vest shares in transferees make adequate arrangements to ensure that divested shareholders will be paid ('performance risk').[127]

A court may also need to consider the arrangements for the transfer of any encumbered shares.[128]

A commentary on developments in the case law on exclusivity provisions and break fees is provided by Justice KE Lindgren of the Federal Court, in 'Private Equity and Section 411 of the Corporations Act 2001 (Cth)' (2008) 26 *Company and Securities Law Journal* 287 at 297-302. His Honour also points out that affidavit evidence conforming to para [55] of *Re APN News & Media Ltd* has now become a feature of applications to the court under s 411 where lock-up devices are involved.

See also HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.071] and A Colla 'Scheme warfare: navigating contests for control in friendly takeover schemes' (2008) 26 *Company and Securities Law Journal* 191 and Damian & Rich, supra footnote 5, at [7.2] and [7.3].

126 *Re Adelaide Bank Limited* [2007] FCA 1582 at [35]: 'I am also satisfied that the [scheme company] put in place a due diligence committee which has rigorously examined the proposed merger.'

127 *Re Tempo Services Ltd* (2005) 53 ACSR 526, *Re SFE Corporation Ltd* [2006] FCA 670, *Re WebCentral Group Ltd* [2006] FCA 937, *Re APN News & Media Ltd* [2007] FCA 770 at [23], *Investa Properties Ltd* [2007] FCA 1104 at [18]-[20], *Re Panbio Ltd (No 2)* [2007] FCA 2101, *Coates Hire Ltd (No 2)* [2007] FCA 2105, *Re Hostworks Group Ltd* [2008] FCA 64 at [32], *Independent Practitioner Network Ltd, in the matter of Independent Practitioner Network Ltd (No 2)* [2008] FCA 1593 at [21], *Re Cytopia Ltd* [2009] VSC 560 at [10]-[11]. Additional binding arrangements outside the scheme may be necessary, given that a scheme binds the company and the shareholders, but not other persons: *Toal v Aquarius Platinum Limited* [2004] FCA 550 at [50], *eircom Holdings Limited, in the matter of eircom Holdings Limited* [2009] FCA 1418 at [23]-[25].

A commentary on developments in the case law on performance risk is found in HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.071].

128 *Re APN News & Media Ltd* (2007) 62 ACSR 400 at [57]-[63], *Re Coles Group Limited* [2007] VSC 389 at [45], *Re Adelaide Bank Limited* [2007] FCA 1582 at [32]-[33], *Orion Telecommunications Ltd* [2007] FCA 1389 at [9], *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at [20]-[29], *Hostworks Group Limited* [2008] FCA 64 at [41], *Macquarie Private Capital A Ltd* [2008] NSWSC 323 at [13]-[14].

A commentary on developments in the case law on the transfer of encumbered shares is found in HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.071].

Purpose and comparable protections

The court may not approve a change of control scheme unless satisfied either that the scheme is not for the purpose of avoiding any of the provisions of Chapter 6 of the Corporations Act[129] (the purpose test) or that ASIC has provided a 'no objection' statement.

The purpose test, set out in s 411(17)(a), does not foreclose the use of a scheme to achieve a change of control provided there is a bona fide commercial reason for choosing the scheme route, such as that the arrangement is too complex to be implemented through a bid or that the scheme can achieve a clear 'all or nothing' outcome within a shorter time than may be practical under a bid, even one with a minimum acceptance condition.[130] In practice, proponents do not seem to have great difficulty in satisfying the purpose test.[131] A party is not taken to be attempting to avoid the bid requirements simply because a scheme, if redesigned, could be effected through a bid.[132]

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129 In *Macquarie Private Capital A Ltd* [2008] NSWSC 323 at [32]-[35], the Court observed that, under amendments introduced in 1999, the former Chapter 6 was rewritten and the part of it dealing with compulsory acquisitions was removed to a new Chapter 6A. However (probably by oversight) the wording of s 411(17)(a) was not amended to include a reference to Chapter 6A.

130 In *Re International Goldfields Ltd* [2004] WASC 112, the Court accepted evidence that the scheme was proposed as a means of guaranteeing a party complete ownership without the delay, cost or uncertainty about achieving full control associated with a takeover under Chapter 6. A brief summary of the relevant case law is found in *Re Equinox Resources Ltd* (2004) 49 ACSR 692 at [18]-[20]. See also *Re Crown Diamonds Nl* [2005] WASC 93 at [47]-[48], *Re Foodland Associated Ltd* (2005) 56 ACSR 352, *Re Lonsdale Financial Group Ltd (No 2)* [2007] VSC 525 at [22]-[24], *Re IWL Limited* [2007] VSC 530 at [6]-[7]. The method of proving the purpose of a scheme, including the onus of proof, is discussed in *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at [46] ff. In that case, in approving the scheme, the Court held (at [57], [79]) that its prima facie purpose was to achieve greater certainty of timing than was possible under a bid.

131 AJ Papamatheos, 'Avoidance of takeover laws: manufacturing reasons for a scheme of arrangement' (2006) 19 *Australian Journal of Corporate Law* 216; N Pathak, '"Public to private" takeover bids' (2003) 21 *Company and Securities Law Journal* 295 at 308.

132 *Re ACM Gold Ltd* (1992) 7 ACSR 231 at 244:

> If there are two ways of achieving the same object and one of them entails the use of Ch 6 [the takeover provisions], the adoption of the second [a scheme] does not mean, without more, that the second was proposed for the purpose of enabling some person to avoid the operation of any of the provisions of Ch 6.

See also *Re Stockbridge Ltd* (1993) 9 ACSR 637 at 652-653; *Re Foundation Healthcare Ltd* (2002) 42 ACSR 252 at 265, *Re International Goldfields Ltd* (2003) 21 ACLC 1199 at 1202.

The key question ASIC considers in deciding whether to lodge a 'no objection' statement under s 411(17)(b) is whether shareholders are adversely affected by any change of control being implemented by a scheme rather than a bid. In so doing, ASIC applies the Eggleston principles (in s 602) to schemes and will not object to using a scheme to change control, provided shareholders receive equivalent (though not necessarily identical) treatment and protections compared with a bid regarding disclosure, the decision-making process, and sharing in the benefits of the scheme:

> Under s 411(17)(b) we [ASIC] are required to decide whether we have no objection to the proposed scheme of arrangement. We are not required to determine or prove the purpose of the scheme.
>
> The primary question we will consider under s 411(17) is whether, having regard to the principles in s 602, shareholders are adversely affected by the takeover being implemented by a scheme of arrangement rather than a takeover bid. We will not consider whether the purpose of the scheme is to avoid making the acquisition under Ch 6 for reasons that do not adversely affect offerees.
>
> We will not intervene under s 1330 to oppose an application before the court on grounds arising out of s 411(17) unless we have concerns relating to the disclosure provided or the principles set out in s 602. However, in these circumstances we may still make submissions as friend of the court, where we do not oppose the scheme proposal but wish to bring certain issues to the court's attention.[133]

Consideration of the purpose test will occur at the second court hearing.[134] The courts have held that they are not required to consider under s 411(17)(a) whether a scheme's purpose is to avoid

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In *Re Lion Selection Ltd* [2009] VSC 546 at [21]-[22], the Court observed that the cases establish that the court should not refuse approval for a scheme merely because it is possible that the arrangement might have been effected under Chapter 6 of the Act and that, in this case:

> The evidence does not indicate that the scheme was proposed for the purpose of avoiding the operation of any of the provisions of Chapter 6 of the Act even though it may be said that Chapter 6 might have been employed to achieve a substantial part of the intended outcome. It is unlikely, however, that Chapter 6 would have so efficiently facilitated the commercial transactions necessary for the outcome achieved by the scheme.

133 ASIC Regulatory Guide 60 at RG 60.101-RG 60.103.

134 *Macquarie Private Capital A Ltd* [2008] NSWSC 323 at [23]-[31], *Re Macquarie Capital Alliance Ltd* [2008] NSWSC 745 at [49].

the Chapter 6 bid requirements if ASIC has provided a 'no objection' statement under s 411(17)(b).[135] The proponent of the scheme must satisfy ASIC of various matters before ASIC will provide this statement.[136] ASIC may decline to provide a statement, even if otherwise satisfied that the scheme meets its requirements, if a shareholder indicates that he or she will object to the scheme at the second court hearing on the ground that it is avoiding the takeover requirements.[137] Even where ASIC provides a 'no objection' statement, a court may still consider the takeover avoidance purpose issue in the exercise of its general discretion whether to approve a scheme.[138]

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135 *Re Coles Group Ltd (No 2)* [2007] VSC 523 at [48] ff sets out the relevant case law on this matter, including *Re Advance Bank Australia Ltd* (1997) 22 ACSR 513 at 519, *Re GIO Australia Holdings Ltd* [1999] NSWSC 1276 at [4], *Re Hibernian Friendly Society (NSW) Ltd* (2002) 44 ACSR 206 and *Re Citect Corporation Ltd* (2006) 56 ACSR 663. As summed up by Robson J in *Re Coles Group Ltd (No 2)* at [75]:

> In my view, in normal circumstances the existence of the no objection statement [from ASIC] would carry with it the implication that ASIC is of the view that members have received all material information that they need for their decision, members have received reasonable and equal opportunity to share in the benefits provided under the scheme and that members are not being adversely affected by the takeover proceeding by a scheme of arrangement rather than by a takeover under Chapter 6. If the court accepted that was the case then the no objection statement may well effectively counter any adverse inference that might have been drawn from the existence of the proscribed purpose [in s 411(17)(a)].

136 The criteria that ASIC will apply in determining whether it will provide an applicant with a 'no objection' statement are set out in ASIC Regulatory Guide 60 at RG 60.104. ASIC states, at RG 60.106, that:

> We will not provide a statement under s 411(17)(b) until the second (confirmation) hearing because we will not be in a position to advise the court properly until we have had an opportunity to observe the entire scheme process. This is also consistent with the wording of s 411(17), which relates the statement to the court's approval of the scheme.

137 ASIC Regulatory Guide 60 at RG 60.109 states that:

> In the past, we have taken the view that if we are satisfied that a scheme meets our policy for providing a 'no objection' statement under s 411(17)(b), but a shareholder undertakes to us that they will object to the scheme on the grounds that it has been proposed to avoid Ch 6 requirements, then we should be cautious in providing a statement under s 411(17)(b). This is because, in providing the statement, ASIC may effectively disenfranchise the shareholder raising the objection.

ASIC Consultation Paper 127 *Schemes of arrangement: Statements under s 411(17)(b)* (December 2009) raises the question whether ASIC should change its position on this matter.

138 The concluding part of s 411(17) provides that 'the Court need not approve a [scheme] merely because a statement by ASIC stating that ASIC has no objection to the [scheme] has been produced to the Court as mentioned in paragraph (b)'.

There is no equivalent statutory role for the court or ASIC with a bid, though a person whose interests are affected by a bid, as well as ASIC itself, can apply to the Takeovers Panel for a declaration of unacceptable circumstances.[139]

3.5 Comparison of scheme and bid approval mechanisms

The shareholder approval procedure for bids differs from that for schemes or reductions of capital. It is not the case that one procedure necessarily favours an intending controller in all circumstances.

3.5.1 Bids

A bid is successful when shareholders holding a sufficient number of shares have accepted the offer in the required manner.[140] The level of acceptances for a successful bid is a matter for the bidder. It may be a level that would achieve effective, but not full, control or the compulsory acquisition threshold level (at least 90% entitlement) if the bidder wishes to achieve complete control.

Shareholders may fail to accept an offer for reasons other than that they oppose it. For instance, they may be uncontactable or apathetic.

In *Re Coles Group Ltd (No 2)* [2007] VSC 523, the Court, after referring to a range of competing judicial authority ([48] ff), concluded, at [77], that:

> the existence of the [takeover avoidance issue] may be a factor to be taken into account in the court exercising its discretion to approve a scheme under para 411(4)(b), but … the existence of the no objection statement which allows the scheme to be considered for approval likewise may be a factor of equal or similar weight and would tend to establish that the existence of the [takeover avoidance] intention is not of particular significance in relation to the court's exercise of the discretion under sub-s 411(4).

See also *Re Mincom Limited [No 3]* [2007] QSC 207 at [40] and [30]-[33].

In *Felix Resources Limited; In the matter of Felix Resources Limited (No. 3)* [2009] FCA 1483 at [24], the Court observed that:

> The tendering of a statement that ASIC has no objection to the approval of a scheme of arrangement is given weight in the sense that the Court will have regard to the views of a regulatory body experienced and practised in the discipline the subject of its area of regulatory engagement. However, the statement is simply weighed in the balance with the relevant degree of emphasis and no more. Circumstances might arise where inferences might be open, and the statement of position by ASIC might assist the Court in determining whether inferences about relevant matters ought to be drawn.

139 s 657C(2).

140 Shareholders can accept offers under a market bid by selling their shares to the bidder. Shareholders can accept offers under an off-market bid in the manner provided for in s 653A (see also Corp Regs 6.8.01).

In any event, non-accepting shareholders effectively vote against a bid, in the sense of reducing the chances of the bidder achieving the compulsory acquisition or other target acquisition threshold.

There is no requirement to convene a shareholders' meeting to discuss the merits of the bid and whether to approve or reject it.

A fundamental protection for shareholders in a bid, in addition to their right to object to the Takeover Panel (see Section 3.4.1), is that the shares of non-accepting shareholders cannot be compulsorily acquired unless one of the following compulsory acquisition requirements is satisfied:

- ***Part 6A.1*:** the offer must be overwhelmingly accepted by offeree shareholders, as reflected in the two step test that a bidder (including any associates) has acquired a relevant interest in at least 90% (by number) of the bid class securities and also has acquired at least 75% (by number) of the securities that the bidder offered to acquire under the bid.[141] When this combined threshold is reached, or the court otherwise permits,[142] the remaining shares may be acquired without the consent of the holders, subject to any dissenter going to court and establishing that the offer consideration is not fair value for the securities[143]

- ***Part 6A.2:*** the bidder must hold a full beneficial interest in at least 90% by number of the total shares (or a relevant class of shares) in a company and must seek to compulsorily acquire the remaining shares within 6 months of achieving this entitlement.[144] If one or more persons who together hold at least

141 s 661A(1)(b). The effect of the 75% requirement can be to push the compulsory acquisition threshold beyond 90%. For instance, for a bidder with an initial entitlement to 70% [80%] of the target company shares, the compulsory acquisition threshold under Part 6A.1 is a 92.5% [95%] entitlement.

142 s 661A(3).

143 s 661E.

144 ss 664A, 664AA. The Part 6A.2 compulsory acquisition provisions would usually be employed by persons who attain the 90% entitlement threshold other than through a bid.

10% of the remaining shares object, the bidder cannot proceed to compulsory acquisition without obtaining court approval.[145]

3.5.2 Schemes

A scheme requires the approval of a simple majority of shareholders under the headcount test and a 75% majority under the voted shares test. Unlike a bid, uncontactable or other non-participating shareholders do not influence the outcome of those votes, though their shares, as well as those of dissidents, may be compulsorily acquired or cancelled if this is provided for under the terms of an approved scheme.

Depending on the level of shareholder participation, a scheme could be approved under the headcount test and the voted shares test by shareholders who represent less than an equivalent of the 'overwhelming proportion' of offeree shareholders needed to reach the compulsory acquisition threshold under a bid. On the other hand, one or more dissenting shareholders who hold a significant, but still minority, proportion of the company's shares may in some circumstances be able to block a scheme.[146]

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[145] ss 664E, 664F. The operation of Part 6A.2 – Part 6A.4 has been the subject of various judicial decisions, including *Capricorn Diamonds Investments Pty Ltd v Catto* [2002] VSC 105 at [21]-[29], *Austrim Nylex Ltd v Kroll (No 2)* [2002] VSC 193 at [6], *Resource Surveys Pty Ltd v Harmony Gold (Australia) Pty Ltd* [2002] FCA391, *ConocoPhillips WA – 248 Pty Ltd v Batoka Pty Ltd* [2005]WASC 184, *Regional Publishers Pty Ltd v Elkington* [2006] FCA 1017 at [2]-[8], *Mitsui & Company Ltd v Hanwha (HK) Company Ltd* [2007] FCA 2070 at [22]-[27], *Espasia Pty Ltd (ABN 74 057 517 825), In the matter of Farm By Nature Pty Ltd (ABN 13 107 299 730)* [2009] FCA 1559.

[146] For instance in *Idameneo (No 123) Pty Ltd v Symbion Health Limited* [2007] FCA 1832, the Court, in the Summary, indicated that a dissenting shareholder with approximately 20% of the issued share capital was able to block a proposed scheme, as only 73.9% of the shares of the company that were voted supported the scheme, therefore not satisfying the 75% voted shares test.

Damian & Rich, supra footnote 5, at [14.5.2] outline and analyse a table that indicates that the total percentage of votes required to approve a scheme under the voted shares test increases above 75% in proportion to the percentage of votes held or controlled by the intending controller (given that any shares held or controlled by the intending controller in the target company will be treated as a separate class of shares, and so cannot be cast at the general meeting of shareholders). As also explained in T Damian, *Bidding farewell to Everest: Reforming the scheme provisions* (Law Council of Australia, Business Law Section, Corporations Workshop July 2005) at 10–11 and footnote 33 of that article:

On one judicial view, primary weight in a scheme should be given to those shareholders who vote on a proposal, as:

> the apathetic shareholder who chooses not to vote upon a scheme should not be presumed to be antagonistic to the scheme or to warrant paternalistic protection.[147]

There are other aspects of the scheme approval procedure that protect the interests of shareholders and counter any perception that the scheme voting procedure is weighted in favour of the intending controller, compared with bids:

- ***the class voting system.*** Where there is more than one class of shareholders, the scheme must be approved by each class.[148] A class 'must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest'.[149] The test has been

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> … if the bidder in a scheme begins with a 20% pre-bid stake, and if half the [remaining] voting electorate participates in the scheme vote [that is, 40% in total], the stake required to block the scheme would be the same as in a takeover [10%, which is 25% of 40%]. If half the electorate vote and the bidder has more than 20% of the target, then a smaller stake will be required to block the scheme than if the transaction had been done by way of takeover. As an example, if a bidder starts at 50%, and if half the electorate vote, a spoiler only needs 6.25% of the shares in the target to block the scheme.

147 *Re Matine Ltd* (1998) 28 ACSR 268 at 295.

148 The votes of different meetings of the same class can be aggregated: s 411(5). ASIC Regulatory Guide 60 at RG 60.22 states that:

> We consider that when there is more than one class of security in a scheme, the resolution put before each of the classes should be conditional on each other class passing the resolution put before it. In this way all members will have an equal opportunity to participate in the benefits accruing from an acquisition, and the equality principles in s 602(c) will be met.

149 *Sovereign Life Assurance Company v Dodd* [1892] 2 QB 573 at 583. The relevant principles for determining the constitution of classes were also set out in *UDL* [2001] 3HKLRD at [27]:

> (2) Persons whose rights are so dissimilar they cannot sensibly consult together with a view to their common interest must be given separate meetings. Persons whose rights are sufficiently similar that they can consult together with a view to a common interest should be summoned to a single meeting.
> (3) The test is based on similarity and dissimilarity of legal rights against the company, not on similarity or dissimilarity of interest not derived from such legal rights. The fact that individuals may hold divergent views based on their private interests not derived from their legal rights against the company is not a ground for calling separate meetings.
> (4) The question is whether the rights which are to be released or varied under the Scheme or the new rights which the Scheme gives in their place are so different that the Scheme must be treated as a compromise or arrangement with more than one class.

applied by reference to the rights or interests of shareholders to be varied under the scheme.[150] The general view is that an intending controller (and any associates) would have a divergent interest from other shareholders on these criteria and could not vote with them on the scheme. Those other shareholders would have to approve the scheme by a separate class meeting.[151] Even within a class, the court may discount or disregard the votes of certain shareholders, or decline to approve a scheme, if they have such divergent or extrinsic interests that the actual vote is not truly representative of the wishes of the shareholders generally.[152] Equally, however, a court may approve a scheme where separate class meetings were not held but it is apparent that the scheme would have been approved if the proper procedure had been followed[153]

- ***shareholder forum.*** Scheme meetings provide shareholders with a forum to debate the issues in an informed manner before voting on the scheme. The disclosure requirements for schemes are comparable to those for bids, namely that shareholders in a scheme should receive equivalent, though not necessarily identical, information to that which they would receive under a

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150 See the comments by Santow J in *Re NRMA Ltd* (2000) 33 ACSR 595 at [76]-[82] and in *Application of Australian Co-operative Foods Ltd* (2001) 38 ACSR 71 at [79] and [81]. In *In the matter of Cashcard Australia Limited* [2004] FCA 223 at [6], the Court commented that:

> The effect of what Santow J said in those cases is that courts ought to be cautious in fractioning the membership into separate classes so as to give one group of members an effective right of veto over the scheme.

See also *Re Hills Motorway Ltd* [2002] NSWSC 897 at [10]-[13], *Re HIH Casualty and General Insurance Ltd* (2006) 57 ACSR 791 at [67]-[70].

Another approach is to have a separate scheme for each class of shareholders, as in *Rural Press Limited, in the matter of Rural Press Limited* [2007] FCA 314.

151 In *Re Hellenic & General Trust Ltd* [1975] 3 All ER 382 at 386, the Court held that a wholly-owned subsidiary of the bidder should have been in a separate class from the other 'outside' shareholders (that is, the shareholders other than the intending controller) in a share cancellation scheme. These principles were applied in *Re Archaean Gold NL* (1997) 23 ACSR 143 at 148. The ASIC position, as set out in ASIC Regulatory Guide 60 at RG 60.94, is that, if the vote is to demonstrate approval by the remaining shareholders, interested parties should fully disclose their interest and either not vote on the resolution to approve the scheme or vote in a separate class. A single shareholder could constitute a separate class where there is a sufficient difference in interest between that shareholder and the general body of shareholders: *Re Hastings Deering Pty Ltd* (1985) 9 ACLR 755.

152 *Re Chevron (Sydney) Limited* [1963] VR 249 at 255, as applied, for instance, in *Re Citect Corporation Ltd* (2006) 56 ACSR 663 at [30].

153 cf *Re Crusader Ltd* (1995) 17 ACSR 336.

bid. Also, a reasonable opportunity must be given at shareholder meetings to debate the scheme.[154] The bid procedure contains no similar requirement for shareholders to meet

- ***right of objectors to go to court.*** Shareholders, or other interested parties, opposing a scheme, even if it is approved at the shareholder meetings, may object at the second court hearing on whether to approve the scheme.[155] To reduce any financial disincentive for a person to object, the general principle is that the scheme company pays the objector's costs, and objectors do not suffer cost orders against them[156]

- ***general court discretion.*** The court has a general discretion whether to approve a scheme, over and above being satisfied that the voting and other procedural requirements have been complied with. The court can exercise its power under s 1322 to cure procedural irregularities.[157] It is not the role of the court to usurp the decision of shareholders by imposing its own commercial judgment on the scheme,[158] nor to satisfy itself that

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154 *Re Direct Acceptance Corporation Ltd* (1987) 5 ACLC 1037 at 1041:

> The chairman of [a scheme] meeting should not terminate debate on a substantive resolution over objection, unless he is satisfied that there has been a reasonable opportunity for the arguments on each side of the question to be put.

155 *Re Central Pacific Minerals NL* [2002] FCA 239 at [31].

156 *Re Matine Ltd* (1998) 28 ACSR 492, *Re NRMA Limited* (2000) 33 ACSR 595 at [42]–[48]. However, cost orders in favour of objectors are usually not made by a court in advance of considering the objection.

157 See, for instance, *Re Capel Finance Ltd* (2005) 54 ACSR 270, *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at [8]-[11], *Re Great Artesian Oil and Gas Limited (No 2)* [2008] FCA 1169 at [5]-[6]. See further Damian & Rich, supra footnote 5, at [4.5].

158 *Re GIO Australia Holdings Ltd* [1999] NSWSC 1276 at [15], *Re NRMA Ltd* (2000) 34 ACSR 261, *Re Central Pacific Minerals NL* (2002) FCA 239 at [12]-[14], *Re Anaconda Nickel Holdings Pty Ltd* (2003) 44 ACSR 229, *Re BRL Hardy Ltd* (2003) 45 ACSR 397 at [20], *Re News Corporation Ltd* (2004) 51 ACSR 394 at [6].

In *Australian Gas Light Company* [2006] FCA 120 at [6], the Court commented:

> The proposed explanatory statement, however, is of considerable size and complexity. It is not for the Court to be satisfied as to the commercial desirability of the proposal, so long as the Court is satisfied that members have been given ample material upon which to base the decision whether to vote in favour or against the proposed scheme.

In *Re Phosphate Resources Ltd* (2005) 56 ACSR 169, the Court said (at [130]):

> It is not for the court to go behind a commercial judgment which it was reasonably open for shareholders properly informed to make.

Also, as observed in *Felix Resources Limited; In the matter of Felix Resources Limited (No. 3)* [2009] FCA 1483 at [21]:

no better scheme could have been devised.[159] However, a court is not bound by a decision of the shareholders in favour of the scheme.[160] The courts have articulated various considerations to take into account in exercising their discretion,[161] including:

- whether shareholders have voted in good faith and not for an improper purpose[162]

- whether the proposal is fair and reasonable in that 'an intelligent and honest man, who is a member of [the

> Fundamentally, the question of whether the proposal ought to be accepted is a matter for the meeting. It is not for the Court to substitute its own view of the merits of the vote, for that of the meeting. If, of course, the meeting reaches a conclusion which seems inconsistent with an objective assessment of the merits of the proposal based on the material put before the meeting, the Court will look closely at the outcome and seek to be satisfied about any matter that might seem to the Court counter-intuitive. Even so, the will of the meeting is paramount subject to the supervision of the Court. If the material clearly explains the proposal and it is capable of acceptance by individuals exercising their best judgment of what is in their own commercial interests or to their own commercial advantage, the Court ought not to withhold approval of the scheme. In the case of a meeting of a single class of members, the Court would need to be satisfied that the vote and thus the will of the meeting had miscarried before withholding approval.

159 *Re Foundation Healthcare Ltd* (2002) 42 ACSR 252 at [44].

160 *Re BTR plc* [2000] 1 BCLC 740 at 747:

> the court is not bound by the decision of the meeting. A favourable resolution at the meeting represents a threshold which must be surmounted before the sanction of the court can be sought. But if the court is satisfied that the meeting is unrepresentative, or that those voting in favour at the meeting have done so with a special interest to promote which differs from the interest of the ordinary independent and objective shareholder, then the vote in favour of the resolution is not to be given effect by the sanction of the court.

161 There is no exhaustive statement of the matters about which the court must be satisfied before granting approval, given the judicial reluctance to attempt any comprehensive statement of relevant criteria: *Re Permanent Trustee Co Ltd* (2002) 43 ACSR 601, *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at [16]. However, a useful overview summary of factors that have been applied is set out in *Re Coles Group Ltd (No 2)* [2007] VSC 523 at [8]-[9].

162 *Re Foundation Healthcare Ltd (No 2)* (2002) 43 ACSR 680. As formulated in *In the matter of Michelago Limited (No 3)* [2006] FCA 1845 at [9], in the context of the resolution of shareholders, the scheme must be one 'that reasonable shareholders, properly informed, might agree to'.

relevant] class, and acting alone in respect of his interest as such a member, might approve of it'[163]

- whether the applicant has brought to the attention of the court all matters that could be considered relevant to the exercise of the court's discretion[164]

- whether there has been full and fair disclosure to shareholders of all information material to their decision

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163 *In re Alabama, New Orleans, Texas and Pacific Junction Railway Company* [1891] 1 Ch 213 at 247, as applied, for instance, in *Re NRMA Ltd* (2000) 34 ACSR 261. A comparable formulation, by Emmett J in *Re Central Pacific Minerals NL* [2002] FCA 239 at [10]-[13], is that the court has a 'duty of satisfying itself that the arrangement is fair and equitable between different classes of security holders, and as between security holders and those who will benefit from [the scheme]'. Likewise, as formulated by Perry J in *Re BRL Hardy Ltd* (2003) 45 ACSR 397 at [21]:

> It is sufficient for the court to reach the view that the proposals embodied in the schemes of arrangement are fair and reasonable and that intelligent, honest and reasonable people acquainted with the terms of the schemes of arrangement would be prepared to enter into them.

An example of a court rejecting a scheme on fairness grounds, even though approved by shareholders, is *Re Direct Acceptance Corporation Ltd* (1987) 5 ACLC 1037 at 1043–1044, where the scheme would have imposed a capital gains tax liability on a significant proportion of shareholders who voted against the scheme or failed to vote.

However, subject to the fairness test, shareholders voting on a scheme are not required to act altruistically: *Phosphate Co-operative Co of Australia Ltd v Shears (No 3)* (1988) 14 ACLR 323. Also, as observed in *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at [19], in a scheme involving cash for shares:

> When properly informed shareholders vote to support a cash offer in such overwhelming numbers as the shareholders in Mincom have done, there is very little scope for a court to determine that the arrangement embodying the offer is fundamentally unfair.

164 *Re Permanent Trustee Co Ltd* (2002) 43 ACSR 601 at [7], *Re Cranswick Premium Wines Ltd* (2002) 44 ACSR 113 at 117, *Re AMP Ltd* [2003] FCA 1465 at [23]. The court may excuse an unintentional oversight in not bringing certain material to its attention if there is nothing untoward in that material that would interfere with the exercise by the court of its discretion to approve the scheme: *Coates Hire Ltd (No 2)* [2007] FCA 2105 at [7].

The court can require individuals to depose to the accuracy of information contained in the explanatory statement prepared for shareholders. For instance, in *Re GIO Australia Holdings Ltd* [1999] NSWSC 1276, corporate officers were required to provide affidavit evidence that certain documents inspected by them subsequent to the issue of the scheme documents did not materially affect the accuracy of the scheme documents.

The court may also require affidavit evidence on other matters. See, for instance, *Re APN News & Media Ltd* (2007) 62 ACSR 400 at [55].

whether to approve the scheme.[165] A court may decline to permit a meeting of shareholders, or to approve a scheme, if the disclosure is defective.[166] The court may order further disclosure to shareholders, or further shareholder meetings, if there is a material change in circumstances after the initial court order for the meetings or after the shareholder meetings[167]

- whether minority shareholders would be oppressed under the scheme[168]

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165 The general principles are set out in *Re NRMA Ltd* (2000) 33 ACSR 595 at [15]-[19] and *Re NRMA Ltd* (2000) 34 ACSR 261 at [30].
In *Re Coles Group Ltd (No 2)* [2007] VSC 523, the Court approved a scheme that had been overwhelmingly approved by shareholders and where full disclosure had been made, even though the scheme may not have given shareholders a full premium for the change of control.
The court will not approve a scheme if shareholders did not vote on a fully informed basis: *Re Phosphate Resources Ltd* (2005) 56 ACSR 169. According to the Court in *Re Pheon Pty Ltd* (1986) 11 ACLR 142 at 156:

> the factual cards must not be played close to the chest but laid face up on the table in good lighting conditions.

Any new material information that arises or emerges after the notice of the meeting has been sent to the shareholders, but before the meeting takes place, must be brought to the attention of those attending the meeting: *Re AMP Ltd* [2003] FCA 1479 at [8]. However, a fundamental omission or misstatement in an explanatory statement, upon the basis of which members (or creditors) have decided whether to attend the meeting or vote by proxy, may not be capable of being cured by disclosure at the meeting: *Re HIH Casualty and General Insurance Ltd* (2006) 57 ACSR 791 at [79]-[96].
A court may exercise its discretionary power under s 1322 to relieve procedural breaches, such as a failure to give a sufficient period of notice to some shareholders: *Re Bolnisi Gold NL (No 2)* [2007] FCA 2078 at [40]-[43].

166 *Re StateWest Credit Society Ltd* (2005) 56 ACSR 453, upheld at 56 ACSR 613.

167 The principles regarding further disclosure to shareholders are discussed in *Cleary v Australian Co-operative Foods Ltd (No 2)* [1999] NSWSC 991 at [26]-[27] and *Application of Australian Co-operative Foods Ltd* (2001) 38 ACSR 71 at [101]. In *Re James Hardie Industries Ltd* (2001) 39 ACSR 552, the Court considered whether to order further shareholder meetings, or give shareholders an opportunity to alter their vote, in light of changed circumstances occurring after the shareholder meeting that approved the scheme and before the final court determination of the scheme. In that case, the Court considered that the new information would not lead reasonable shareholders to alter their decision so as to alter the result of the shareholders' meeting. In these circumstances, it was sufficient that any objectors could come to court to make submissions with respect to the effect of the changed circumstances.

168 In *Re Ranger Minerals Ltd* (2002) 42 ACSR 582, the Court indicated that it might decline to approve a scheme where oppression of minority interests is an issue.

- whether the interests of other groups who are not parties to, but are affected by, the scheme are appropriately dealt with[169]
- whether the scheme offends public policy.[170]

The court may also require in particular cases that further processes be undertaken before it will approve a scheme.[171]

The central role of the court in approving or rejecting schemes has been put forward in explanation of the lower approval thresholds under a scheme than under a bid:

> Under [the UK scheme provisions] an arrangement can only be sanctioned if the question of its fairness has first of all been submitted to the court. Under [the UK bid provisions], on the other hand, the matter may never come to the court at all. If it does come to the court then the onus is cast on the dissenting minority to demonstrate the unfairness of the scheme [similar to the Australian post-bid compulsory acquisition provisions]. There are, therefore, good reasons for requiring a smaller majority in favour of a scheme under [the UK scheme provisions] than the majority which is required under [the UK bid provisions] if the minority is to be expropriated.[172]

Also, as observed by the Takeovers Panel:

> Courts in Australia have observed that in Schemes of Arrangement the proposal is brought to the Court by the management of the company with no recognised

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169 For instance, in *Stork ICM Australia Pty Ltd v Stork Food Systems Australasia Pty Ltd* [2006] FCA 1849, the Federal Court approved a members' scheme on being satisfied that potential asbestos claimants against the company would be protected, in the sense of being no worse off under the scheme than under the previous arrangement.

170 *Re Cascade Pools Australia Pty Ltd* (1985) 9 ACLR 995. In *Re Universal Liquors Pty Ltd* (1991) 5 ACSR 104, the Court refused to approve a scheme that would allow a company to circumvent provisional liquidation and go back into the commercial community with an accumulated debt and no substantial assets.

171 These additional processes can include that the shareholder approval process be recommenced, that a further meeting be held or that shareholders be permitted to recast their votes (*Cleary v Australian Co-operative Foods Ltd (No 2)* [1999] NSWSC 991 at [46], [118]-[120]), or that shareholders be given additional time to appear at the second court hearing and raise objections (*Re James Hardie Industries Ltd* (2001) 39 ACSR 552).

172 *Re National Bank Ltd* [1966] 1 All ER 1006 at 1013.

> contradictor. Courts have taken this to mean that their role is also to be more careful about their scrutiny of disclosure, mechanisms, classes etc and fulfil the role that a contradictor might take. … Indeed, it is the scrutiny of the court in a number of areas which is regularly cited by supporters of Schemes of Arrangement as why it is reasonable and fair for a Scheme of Arrangement to have a lower threshold for compulsory acquisition than a takeover bid.[173]

- ***role of the Takeovers Panel.*** The Takeovers Panel has proceeded on the basis that it has power to consider any unacceptable circumstances arising from a change of control through a scheme.[174] However, given the central role of the court in the scheme approval process, the Panel has indicated that it will not become involved in a scheme matter that is before the court.[175]

3.6 Share capital reduction

3.6.1 Role in changing control

A reduction of share capital under ss 256B–256E, under which shares in the company are cancelled, may be undertaken for various purposes, including to achieve a change of control, either through a reduction alone or as part of a scheme.

A cancellation scheme must comply with the share capital reduction requirements as well as the scheme requirements.[176] Both sets of requirements would apply, for instance, if, in addition to a share cancellation, the intention is that affected shareholders shall, say, also acquire shares in another company.[177] The usual practice in these circumstances is for the scheme and the capital reduction requirements to be inter-conditional, in that neither takes effect until

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173 *Re Colonial First State Property Trust Group (No 1)* (2002) 43 ACSR 143 at [88]-[89].
174 *St Barbara Mines Ltd* [2000] ATP 10 at [21].
175 id at [30]-[32].
176 *Re Australian Consolidated Press Ltd* (1994) 14 ACSR 639, *Re Theatre Freeholds Ltd* (1996) 20 ACSR 729 at 735, *Re Vector Capital Ltd* (1997) 23 ACSR 182, *Re Tiger Investment Company Ltd* (1999) 33 ACSR 438.
177 *Re Hunter Resources Ltd* (1992) 7 ACSR 436, *Alinta Ltd (No 3)* [2007] FCA 1416.

both are approved (by shareholders and, in the case of the scheme, also by the court).[178]

Where the same result could be achieved by a capital reduction, a bid or a scheme, it is not necessary to choose the bid or scheme.[179] The choice between a scheme and a capital reduction may be influenced by various factors including taxation considerations.[180]

A reduction of capital can be either an equal reduction or a selective reduction.

An equal reduction is one that applies to each shareholder in proportion to the number of shares held and where the terms of the reduction are the same for each shareholder.[181] This form of reduction requires only a simple majority ordinary resolution, with all shareholders being entitled to vote, given that all shareholders are

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178 See, for instance, *eircom Holdings Limited, in the matter of eircom Holdings Limited* [2009] FCA 1418 at [17].

179 In *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219 at 235, the Court held that the bid procedure does not have to be followed in preference to a reduction of capital to achieve a change of corporate control.
In *Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* (2001) 40 ACSR 221 at [83], the Court held that:

> A scheme of arrangement procedure is not to be followed merely because it is there … and a selective capital reduction is not excluded because the same outcome could have been achieved by a scheme of arrangement.

180 B Jolly in his paper 'Moving to 100% ownership after a private equity bid' in RP Austin & AF Tuch (eds), *Private Equity and Corporate Control Transactions* (Ross Parsons Centre of Commercial, Corporate and Taxation Law) Monograph 3 (2007) commented, at 73, in the context of considering whether to use a scheme or a capital reduction where the intending controller already has between 60% and 84% entitlement:

> Capital reductions after the tax streaming rules that commenced in 2000 are particularly unattractive unless you have a lot of franking credits and a lot of capital. So you find that in most cases you would not look at a selective capital reduction until you are close to 75 to 80%, because of those tax rules.

181 s 256B(2). The distinction between an equal reduction and a selective reduction is discussed in *Re ETRADE Australia Ltd* (1999) 30 ACSR 516, *Re AMP Ltd* [2003] FCA 1465 at [6]-[9], and *Idameneo (No 123) Pty Ltd v Symbion Health Limited* [2007] FCA 1832 at [80]-[90]. In *Idameneo*, the Court held that the reduction was an equal reduction, as its terms were the same for all shareholders, notwithstanding that foreign shareholders, unlike local shareholders, had to receive their consideration in cash rather than in shares, given foreign laws that impeded in specie distributions.

to be treated in a similar manner.[182] An equal reduction may be one element of a scheme.[183]

A selective reduction is where all the shares of the company, other than those held by the intending controller, are cancelled, with holders of the cancelled shares being paid out or allotted shares in another company. This form of reduction can be used in lieu of a scheme to effect a change of control.[184]

There are various requirements applicable to a reduction, whether selective or equal, including that:

- the reduction must not be inconsistent with the company's constitution or shareholder class rights[185]
- shareholders must be provided with all information known to the company that is material to the decision on how to vote on the resolution[186]
- the reduction must be 'fair and reasonable to the company's shareholders as a whole'[187]
- the reduction must not materially prejudice the company's ability to pay its creditors.[188]

3.6.2 Approval process for a selective reduction

Two special resolutions, each employing a shares test, are required for a selective reduction of shares.[189] This may create a significant hurdle for an intending controller:

- the first special resolution (referred to in s 256C(2)(a)) provides that 'no votes [may be] cast in favour of the resolution by any person who is to receive consideration as part of the

182 s 256C(1).
183 See, for instance, *Re ETRADE Australia Ltd* (1999) 30 ACSR 516, *Re AMP Ltd* [2003] FCA 1465.
184 *Re Goldfields Kalgoorlie* (2000) 34 ACSR 737 at [5] comments on the use of selective reductions of capital to eliminate minority shareholdings.
185 See s 256E, notes 6 and 7.
186 s 256C(4).
187 s 256B(1)(a).
188 s 256(B)(1)(b).
189 s 256C(2).

reduction'.[190] The apparent purpose of this restriction is to ensure that the resolution is not passed through the influence of those who stand to receive some payment or other consideration from the company under the selective reduction (which might otherwise be too generous). There is some debate, however, about its application where, in effect, the reduction is being funded by a party seeking corporate control rather than the company. The question is whether consideration received under a selective reduction scheme in those circumstances is received 'as part of the reduction' under s 256C(2)(a).[191] If so, only the intending controller can vote shares in favour of the selective reduction resolution, as those shares will not be cancelled under the reduction. In consequence, an intending controller with a low entitlement may be unable to have the resolution passed in the

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190 *Re Tiger Investment Company Ltd* (1999) 33 ACSR 438 at [31]. Santow J at [33] seemed to suggest that the wording of s 256C(2)(a) ('with no votes being cast in favour of the resolution by any person who is to receive consideration as part of the reduction') may result in a shareholder whose shares are to be cancelled effectively negating the resolution by voting in favour of it:

> it may give a veto right to any shareholder who is to receive consideration as part of the reduction to prevent the reduction from being passed.

A contrary interpretation of the provision is that it simply invalidates any votes in favour of the resolution by a shareholder who is to receive consideration as part of the reduction, without any veto right.

191 If the consideration which target shareholders are to receive under a selective reduction scheme is regarded as 'consideration as part of the reduction', any shareholder can vote against the transaction, but no shareholder (other than the intending acquirer, who may have only a negligible holding) can vote in favour. In *Re Tiger Investment Company Ltd* (1999) 33 ACSR 438, Santow J at [31]-[32] gave some support to the argument that the consideration being provided under a cancellation scheme is consideration as part of the scheme and not consideration as part of the reduction, at least where the consideration, in effect, is being provided by the acquirer:

> The logic of this exclusion [of shareholders who are to receive consideration under the terms of s256C(2)(a)] is clear. The remaining shareholders could be disadvantaged if the capital reduction were too generous. The exclusion ensures that the resolution is not passed by reason of the influence of shareholders that stand specially to benefit from the capital reduction. … Although it is not necessary to decide the point at this stage, there is merit in the argument that neither class of shareholder is precluded from voting because the reduction involves no liberation of the company's assets and therefore no risk that it is too generous to one class of shareholders over another.

face of active opposition from a small group of dissenting shareholders[192]

- the second special resolution (referred to in the final paragraph of s 256C(2)) is confined to shareholders whose shares are to be cancelled. In a prospective change of control, the future controller cannot vote on that resolution, as that person's shares are not to be cancelled. This effectively places the decision on whether the selective reduction is to proceed in the hands of the other shareholders.

A special resolution is based on the voting rights attached to the shares (usually, but not always, one vote per share). It requires the approval of 75% of the votes actually cast on the resolution, either in person or by proxy. Depending on the number of participating shareholders, this may be less than a majority of the total issued share capital. There is no headcount test.

3.6.3 Role of the court

Capital reductions, unlike schemes, do not require prior court approval. However, a dissident shareholder can seek an injunction to restrain a reduction, arguing, for instance, that disclosure has been incomplete or misleading or that the terms of the proposed reduction are not fair and reasonable to the shareholders generally.[193] Unlike the general practice with schemes,[194] an objector may have to pay costs in some circumstances.

ASIC may seek an injunction to restrain possible breaches of the reduction of capital requirements[195] or may intervene in any court proceedings challenging a reduction of capital.[196] Also, ASIC or any other interested party may apply to the Takeovers Panel if it appears that unacceptable circumstances may have occurred in relation to a

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192 Damian & Rich, supra footnote 5, at [3.2.4] point out that 'if the bidder held 10% of the target shares, a spoiler would only need to cause 3.34% of the votes [of the company's issued voting capital] to be cast against the reduction to defeat the relevant resolution'.

193 s 1324, as referred to in s 256E, note 2.

194 See text related to footnote 156.

195 s 1324.

196 s 1330.

reduction of capital, having regard to the effect of the transaction on control of a company.[197]

Where a judicial remedy is sought, the court may be inclined to apply principles from the case law that developed under the pre-1998 capital reduction procedure, which required court approval. Those principles include:

- a reduction is not unfair or unreasonable simply because it involves the expropriation of the shares of dissident or apathetic shareholders[198]
- it is not the role of the court to determine the commercial merits of the reduction[199]
- the adequacy of the consideration to be given for shares subject to the reduction is an important factor in determining possible prejudice.[200]

The Advisory Committee returns to this question of voting on reductions of capital in chapter 8 of this report (see Sections 8.3 and 8.7.3).

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197 s 657C(2).

198 *Nicron Resources Ltd v Catto* (1992) 8 ACSR 219 at 228–231. See also *Winpar Holdings Ltd v Goldfields Kalgoorlie Ltd* (2001) 40 ACSR 221 at [85]-[98], which confirmed that the principles in *Gambotto v WCP Ltd* (1995) 182 CLR 432, 127 ALR 417, which restrict the circumstances where shares may be expropriated, do not apply to a capital reduction.

199 *Catto v Ampol Ltd* (1989) 15 ACLR 307 at 321–322, *Ramsay Health Care Ltd v Elkington* (1992) 7 ACSR 73 at 77–78.

200 *Re Hunter Resources Ltd* (1992) 7 ACSR 436, *Re Stockbridge Ltd* (1993) 9 ACSR 637, *Melcann Ltd v Super John Pty Ltd* (1994) 13 ACLC 92, *Re Rancoo Ltd* (1995) 17 ACSR 206.

4 Information for shareholders

This chapter discusses the provision of information to shareholders about schemes, the liability standard and defences for disclosure breaches, and the criterion for an expert opinion on the merits of a scheme.

4.1 Scheme statement

The notice of a scheme meeting that is given to shareholders must contain a statement 'explaining the effect of the compromise or arrangement',[201] include prescribed information[202] and set out any other information 'within the knowledge of the directors' that has not previously been disclosed and which 'is material to the making of a decision by a member whether or not to agree to the compromise or arrangement'.[203] There is no express requirement on directors under Part 5.1 to go further and make inquiries.

4.1.1 Content of disclosure

The courts recognise that the obligation to make full and fair disclosure to shareholders should be approached in a practical way, having regard to the complexity of the proposal. The information provided should be intelligible to reasonable members of the shareholder class to whom it is directed and be likely to assist rather than to confuse.[204] The court may excuse a defective disclosure or other procedural irregularity.[205]

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201 Subparagraph 412(1)(a)(i) identifies some information to be included in the explanatory statement, namely any material interests of the directors and any particular effect that the proposed scheme may have on those interests.

202 s 412(1)(a)(ii), Corp Reg 5.1.01(1)(b) and (c) and Corp Regs Schedule 8 Parts 3 and 4.

203 s 412(1)(a)(ii). In *Phosphate Co-operative Co of Australia Ltd v Shears (No 3)* (1988) 14 ACLR 323 at 345, the Court observed that a fact is material if it 'would tend to influence a sensible member's decision on whether the scheme is in his interests'.

204 *Re Crusader Ltd* (1995) 17 ACSR 336 at 343.

205 s 1322, as applied, for instance, in *Re Ferro Constructions Pty Ltd* (1976) 2 ACLR 18, *Re Bolnisi Gold NL (No 2)* [2007] FCA 2078 at [40]-[43].

In practice, scheme documents circulated to shareholders are in many cases voluminous and complex. While adding to administrative costs, documents of this nature may be of limited assistance in conveying to shareholders the essence of the scheme and its implications.

It is noted that the scheme provisions:

- contain no equivalent of the requirement in the prospectus and various other disclosure provisions that information 'must be worded and presented in a clear, concise and effective manner'[206]
- do not have the equivalent of the short-form prospectus provisions, which in some cases allow for incorporation of information in documents by reference[207]

though the court may have some discretion to permit abbreviated disclosures.[208] The onus for effective communication of the required information rests on the proponents of a scheme.

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206 For instance, ss 249L(3), 715A, 942B(6A), 942C(6A), 1012G(3A), 1013C(3).

207 This lack of an incorporation by reference mechanism has various consequences, including in regard to the content of an expert's report, as explained in ASIC Regulatory Guide 60 at RG 60.84:

> Although we recognise the benefit of concise expert reports (see RG 111.72), s 412(1)(a)(ii) requires an explanatory statement to contain all material information. The Corporations Act does not contain a mechanism that allows information to be incorporated by reference into an explanatory statement. Further, ASIC does not have the power to provide relief from s 412(1)(a)(ii) to facilitate incorporation by reference. Accordingly, if an explanatory statement only contains a concise expert report, the concise report will need to include all material information that is contained in the full report. The concise expert report must include a statement that it includes all material information that is contained in the full report.

Compare s 636(1)(g), which applies the incorporation by reference prospectus provision (s 712) to a bidder's statement.

208 The court may exercise a discretion to permit the distribution in a scheme of an explanatory statement containing a concise and clear summary of the effect of various proposed changes, in lieu of circulating the full text of the document that would implement these changes. Support for this proposition can be drawn from some general observations of the Full Federal Court in *Fraser v NRMA Holdings Ltd* (1995) 127 ALR 543 at 556 (a case dealing with a 'prospectus' in a proposed demutualisation):

The introduction of a 'clear, concise and effective' requirement for the explanatory statement, as well as the provision for incorporation of information by reference in scheme documents, could facilitate efforts to provide shorter and less complex documents and assist shareholders to understand the proposal on which they are asked to vote.

Another means to assist in making information more accessible to shareholders would be to provide that, while the complete information must be lodged with ASIC, shareholders need only receive a 'roadmap' of that information, together with a reference to a corporate website where the full information is available. Also, to assist shareholders, the information on the company's website could be presented in summary form, with links to more detailed information elsewhere on that website on particular matters (for instance, accounting information) for interested shareholders.

A related issue is whether the checklist of disclosure items, set out in Corp Regs Schedule 8 Part 3, should be omitted (given the general disclosure requirement on directors) or alternatively be made more consistent with the required content of bid documents.[209]

One commentary[210] has proposed that, given the general disclosure requirements in ss 411 and 412, the checklist requirements in Schedule 8 Part 3 be repealed, though the requirements concerning

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> The need to make full and fair disclosure must be tempered by the need to present a document that is intelligible to reasonable members of the class to whom it is directed, and is likely to assist rather than to confuse … In complex cases it may be necessary to be selective in the information provided, confining it to that which is realistically useful.

Also, in *Re Mirvac Ltd* (1999) 32 ACSR 107 at [22]-[23], Austin J agreed to the distribution of a summary of proposed constitutional changes to various entities, rather than the full text of the proposed new constitutions:

> In my opinion it is not necessary in the present case to add to the burden of paper by distributing the full text of the relevant new constitution. Having inspected the three constitutions, I doubt that they would convey much useful information to the lay reader, given their predictable length and complexity. Instead it is much more useful, consistently with principles frequently enunciated by the courts with respect to disclosure in a notice of meeting … to give a concise and clear summary of the effect of the changes which is materially comprehensive. I do not say that such an approach is always justifiable, but rather that it is clearly justifiable here in view of the overall complexity of the proposals and the particular complexity of the constitutional changes which are necessary to implement them.

209 s 636 (content of bidder's statement) and s 638 (content of target's statement).

210 Damian & Rich, supra footnote 5, at [5.6.5].

the directors' recommendation[211] and the independent expert's report[212] should be included in the scheme provisions of the Corporations Act.

4.1.2 Supplementary disclosure

The directors of a company for which a scheme is proposed have a duty to bring to the attention of shareholders and the court any change of circumstances that is material to the shareholders' decision on the scheme. This duty continues until the shareholders have made their decision and the court has decided at the second hearing whether to approve the scheme.[213]

In the case of bids, there is a statutory regime for supplementary disclosure by bidders and targets.[214] There is no equivalent legislative procedure for schemes, though the court can approve amended or supplementary disclosures.[215] It is unclear whether companies must first approach the court (or ASIC) before releasing supplementary information, though this would be the prudent course.[216]

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211 Schedule 8, rule 8301(a).

212 Schedule 8, rules 8303, 8306.

213 *Cleary v Australian Co-operative Foods Ltd (No 2)* [1999] NSWSC 991 at [26]-[27]. See also *Re NRMA Ltd* (2000) 33 ACSR 595 at [19], *Re Bulong Nickel Pty Ltd* (2003) 21 ACLC 191 at [5].

214 ss 643–647.

215 See, for instance, *Re Citect Corporation Limited* (2006) 56 ACSR 663, *Re Excel Coal Limited* (2006) 60 ACSR 184 and *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 as examples of where the court has approved amendments to the terms of a scheme after the explanatory statement has been dispatched. In *Anzon Energy Ltd (No 2)* [2008] FCA 1579 at [6]-[8], Lindgren J declared that the scheme company was justified in publishing an identified document as a supplement to its explanatory statement. See also *BlueFreeway Limited, in the matter of BlueFreeway Limited (No 2)* [2009] FCA 708 at [3]-[4].

216 Contrast *Cleary v Australian Co-operative Foods Limited (No 3)* [1999] NSWSC 1062 at [51] (no obligation to make an application to the court) with *Application of Australian Co-operative Foods Ltd* (2001) 38 ACSR 71 at [101] (new information should promptly be brought to the attention of the court). In *Coates Hire Ltd (No 2)* [2007] FCA 2105 at [7], the Court was critical of a company that circulated supplementary information to shareholders without first obtaining court approval. See also *Felix Resources Pty Ltd; in the matter of Felix Resources Pty Ltd (No 2)* [2009] FCA 1337 at [6] and [17], where the company first notified ASIC and then applied to the Court for approval to circulate supplementary information.
ASIC policy, as stated in ASIC Regulatory Guide 60 at RG 60.91 is that:

Damian & Rich have argued that, to provide certainty and structure, the scheme provisions should be amended to incorporate a supplementary disclosure regime modelled on that applicable to bids.[217] A prescribed procedure for schemes could specify, for instance, how supplementary information is to be provided to shareholders in a manner that ensures that they have a reasonable opportunity to consider it before voting on a proposed scheme.

4.2 Liability and defences for disclosure breaches

The preparation by a company of an explanatory statement for a scheme is subject to the general provisions directed at misleading or deceptive conduct.[218] A person who suffers loss or damage through a disclosure breach may recover from the company or any other person 'involved' in the contravention.[219] There are no statutory 'due diligence' defences, though the court has some power to relieve a person from a civil penalty liability.[220]

By contrast, bid documents (as well as fundraising documents) are subject to a specific liability and 'due diligence' defence regime for defective disclosures,[221] to the exclusion of the general misleading or deceptive conduct provisions.[222]

Damian & Rich have argued that information supplied in an explanatory statement under a scheme should be subject to a stand-alone liability and defence regime modelled on that applicable to bids:

> It is plainly anomalous that issuers (and those involved in the issue) of takeover, fundraising and financial services and

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> If a scheme company proposes to amend the terms of a scheme, or otherwise provide supplementary information to its members, after the explanatory statement has been dispatched, that supplementary information will need to be given to ASIC for review prior to being given to the court for approval. We will apply the same principles in reviewing supplementary information as we do when reviewing explanatory statements: see RG 60.93 for the timing required for the dispatch of supplementary information.

217 Damian & Rich, supra footnote 5, at [5.6.6].
218 s 1041H(1) and ASIC Act s 12DA(1).
219 s 1041I(1), s 79 and ASIC Act s 12GF(1).
220 s 1317S(2).
221 For bids: ss 670A–670F. For fundraising documents: ss 728–733.
222 For bids and fundraising documents, s 1041H(3) and ASIC Act s 12DA(1A).

product disclosure documents have the protection of defences to liability, whereas issuers (and those involved in the issue) of scheme of arrangement documents do not.[223]

4.3 Standard for expert's opinion

An independent expert's report on a scheme must state whether, in the opinion of the expert, the proposed scheme is in 'the best interests' of the shareholders of the company the subject of the scheme.[224] This contrasts with the formulation in a bid, namely whether the takeover offers 'are fair and reasonable'.[225]

It has been noted in some judicial decisions that some independent experts construe the term 'best interests' as having a similar meaning to 'fair and reasonable', or combine both tests.[226] However, it has been argued that, given the 'functional equivalence' between schemes and bids, it is undesirable that experts may be required to apply different standards, depending on the transaction structure used.[227]

One possibility is for the 'fair and reasonable' test to apply to schemes as well as bids. Another possibility is to adopt a standard 'best interests' test for bids and schemes, which would also prevent

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223 Damian & Rich, supra footnote 5, at [5.9.1].

224 See Corp Regs Schedule 8 Part 3, rule 8303. See also ASIC Regulatory Guide 60 at RG 60.74-RG 60.78 and ASIC Regulatory Guide 111 and Regulatory Guide 112 concerning the content of that report.

225 s 640(1).

226 *Re Lonsdale Financial Group Ltd* [2007] VSC 394 at [11]. In *Re Dyno Nobel Limited* [2008] VSC 154 at [28] ff, the Court approved an independent expert's report that had been prepared having regard to ASIC Regulatory Guide 111 at [RG 111.9]–[RG 111.11], which discusses the meaning of 'fair and reasonable' in the context of takeover bids.
In *Re Cytopia Ltd* [2009] VSC 560 at [5]-[8], the Court at a first hearing considered a report by an independent expert that a proposed scheme was 'not fair but is reasonable to, and in the best interests of, [the company's] shareholders in the absence of a superior proposal'. The Court, at [6], referred to case law that courts should adopt a cautious approach to the approval of any scheme that the independent expert considers 'not fair', particularly when it may involve an offer at an undervalue. For the reasons set out at [7]-[8], the Court took the view that the conclusion in the expert's report that the proposed scheme was 'not fair' was not a good reason for declining to make an order convening a meeting of shareholders to consider the proposed scheme.

227 Damian & Rich, supra footnote 5, at [5.7.2], referring to L McDonald, G Moodie, I Ramsay and J Webster, *Experts' Reports in Corporate Transactions* (The Federation Press, 2003) at 59–65.

split assessments, such as 'reasonable but not fair'.[228] In other contexts, such as s 181, a 'best interests' requirement does not impose a 'best possible' standard.[229]

4.4 Submissions

The discussion paper invited comments on possible changes that might better facilitate effective disclosure of scheme information to shareholders, as well as appropriate obligations and defences for persons providing that information.

4.4.1 Content of disclosure

Clear, concise and effective

The discussion paper raised the question whether the scheme provisions should contain the equivalent of the requirement in the prospectus and various other disclosure provisions that information 'must be worded and presented in a clear, concise and effective manner'.

One respondent observed that retail shareholders frequently do not read scheme and bid documents, as they are too voluminous.[230]

Some respondents[231] supported introducing a 'clear, concise and effective' requirement, arguing that it would:

- reduce the incentive to provide excessive disclosure merely to minimise liability
- achieve consistency with the requirements for other disclosure documents.

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228 McDonald, Moodie, Ramsay and Webster, *Experts' Reports in Corporate Transactions* at 64.

229 RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) at 7.2.

230 Australian Shareholders' Association.

231 Allens Arthur Robinson, Australian Shareholders' Association, ASIC, Wee & Nehme, Law Council of Australia.

However, another respondent[232] argued that:

- the interaction of the requirement with the general disclosure standard would be unclear

- market practice suggests that it has not materially improved the quality of other disclosure documents

- ASIC and the court adequately protect investors

- proving that the test has been satisfied may require 'expert' evidence on an inherently subjective and uncertain judgement, leading to increased costs.

Incorporation by reference

The discussion paper raised the question whether the scheme provisions should include the equivalent of the short-form prospectus provisions, which in some cases allow for incorporation of information in documents by reference.

Some respondents[233] supported statutory provision for incorporation by reference, on the basis that:

- it would be consistent with, and would promote, clear, concise and effective disclosure

- the effectiveness of disclosure would be enhanced by making detailed or complex information available only to those shareholders who wish to see it.

Submissions were specifically invited on the related question of whether to permit scheme companies to send shareholders a brief 'roadmap' of material information, together with a reference to a website (arranged by the company) where full information is available.

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232 Minter Ellison.

233 Allens Arthur Robinson, Australian Shareholders' Association, Law Council of Australia, Minter Ellison.

Some respondents[234] supported this approach, arguing that it:

- would make the information more comprehensible, less costly and more environmentally friendly
- is in line with the views of industry bodies.

One of those respondents[235] added that information should be accessible either on the web or by requesting a hard copy, to allow for shareholders who lack Internet access or the confidence to access this information on the web.

The discussion paper also raised the question whether it is appropriate to allow the information about a scheme on the company's website to be presented in summary form, with links to more detailed information on particular matters (for instance, accounting information) for interested shareholders.

Respondents did not have a strong view on this matter.

Corp Regs Schedule 8 Part 3

Submissions were invited on whether the specific disclosure obligations, set out in Corp Regs Schedule 8 Part 3, should be omitted or alternatively be revised and, if so, in what manner. Particular reference was made to the obligation of each director to indicate whether he or she recommends that shareholders accept or reject the scheme, and the requirements relating to the independent expert's report.

Some respondents[236] supported the principle of repeal of the specific disclosure obligations in Corp Regs Schedule 8 Part 3, arguing that much of the information referred to in the regulations is irrelevant or covered by general disclosure requirements. However, some of those respondents[237] considered that the requirement for each director to disclose whether he or she recommends acceptance or rejection of the scheme, together with a statement of reasons, is an important safeguard for shareholders where a fundamental change in the company is being proposed and there are dissenting directors.

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234 Australian Shareholders' Association, Wee & Nehme, Law Council of Australia, Law Society of NSW, Computershare.

235 Australian Shareholders' Association.

236 Allens Arthur Robinson, Wee & Nehme, Law Council of Australia.

237 Wee & Nehme, Law Council of Australia.

By contrast, another respondent[238] considered that the specific disclosure obligations in Corp Regs Schedule 8 Part 3 should not be omitted but revised to be more consistent with the required content of bid documents.

Supplementary disclosure

The Committee invited comments on whether there should be greater statutory guidance concerning supplementary disclosure, in particular whether the scheme provisions should be amended to incorporate a supplementary disclosure regime similar to that for takeover bids.

Some submissions[239] supported a supplementary disclosure regime for schemes, arguing that it would reduce the risk of a successful challenge to the scheme on disclosure grounds at the second court hearing.

Another view[240] was that the current process adopted by the court to deal with new or corrective information is sufficient.

4.4.2 Liability and defences for disclosure

The Committee invited comments on whether the information supplied in an explanatory statement under a scheme should be subject to a stand-alone liability and defence regime modelled on that applicable to bids.

Several submissions favoured such a single liability and defence regime for information in a scheme explanatory statement.[241] It was also argued that, where parts of scheme documents are prepared by the company and parts by a third party (such as the intending controller in a change of control scheme), parties should be liable only for their own disclosures, not for material put forward by another party.[242]

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238 Law Society of NSW.
239 Australian Shareholders' Association, Corrs Chambers Westgarth, Wee & Nehme, Law Council of Australia, Law Society of NSW, Minter Ellison.
240 Allens Arthur Robinson.
241 AICD, Alan Cameron AM, Wee & Nehme, Law Council of Australia, Law Society of NSW, Minter Ellison, Allens Arthur Robinson.
242 Alan Cameron AM, AICD, Allens Arthur Robinson.

4.4.3 Standard for expert's opinion

The Committee invited comments on whether the required standard for formulation of an expert's opinion for a scheme (whether it is in 'the best interests' of the shareholders) should be more consistent with that for a bid (whether it is 'fair and reasonable').

Submissions differed on the merits or possible benefit of changing the current test, and how it might be reformulated.

One submission[243] favoured retaining the best interests test, unless change of control schemes are dealt with separately from other schemes, in which case the best interests test could be replaced with the 'fair and reasonable' standard for change of control schemes.

Some submissions[244] considered that the 'fair and reasonable' test should apply to schemes and bids, arguing that:

- the 'best interests' of diverse groups of shareholders will vary
- given the 'functional equivalence' between schemes and bids, it is efficient and simple to have the same test for both bids and schemes.

Another submission considered that the 'in the best interests of members' test should be incorporated into the 'fair and reasonable' test and the combined test used for bids and schemes.[245]

One respondent,[246] considering that the takeover formulation of 'fair and reasonable' may not be appropriate for all schemes (for instance, in a demerger), suggested an alternative formulation, equally applicable to bids and schemes, namely whether the expert is of the opinion that shareholders should vote in favour of, or accept, the proposal.

Another possible test raised in submissions would be to direct the expert to compare the value of the existing interests of the relevant members with the benefits offered to them under the scheme.[247]

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243 Minter Ellison.
244 Australian Shareholders' Association, Law Society of NSW. See also Damian & Rich, supra footnote 5, at [5.7.2].
245 Wee & Nehme.
246 Law Council of Australia.
247 Abacus – Australian Mutuals.

4.5 Advisory Committee position

The Committee notes that the various matters raised in this chapter about information requirements for schemes and liability and defences for disclosure are part of a broader debate about the effective communication of financial and other information to investors and the market in general. The Committee has, however, confined its views to the issues raised in the discussion paper.

4.5.1 Content of disclosure

Clear, concise and effective

A requirement for information in the explanatory statements to shareholders to be presented in a clear, concise and effective manner should assist in promoting the preparation of scheme documents in a form more likely to be read and understood by shareholders. It would focus more on the information and meaning to be conveyed and discourage companies from including marginal or other information that may result in longer and less comprehensible documents, in the view that more rather than less material is needed in order to minimise possible liability. It would also achieve consistency with the requirements for other disclosure documents.

Incorporation by reference

The Committee supports the general principle that the incorporation by reference in scheme documents of appropriate material (such as information of secondary significance or detail of other documents), the essence of which has been summarised in the documentation sent to shareholders, can be consistent with and help to promote clear, concise and effective disclosure. The effectiveness of disclosure can be enhanced if shareholders are not faced with detailed or complex explanatory information, provided that the information referred to is readily available for those who wish to examine it and the essence of the scheme is explained in the short-form document.

In particular, inclusion in the explanatory statements of an 'information roadmap' that provides an outline and explanation of the essential features of the scheme and the reasons for it, and identifies where further information is readily available, may assist shareholders in understanding the proposal, while being consistent with the provision of information in a clear, concise and effective manner.

The form in which information is presented on a company's website is generally a matter for the company to decide. However, any information about a proposed scheme would remain subject to the general requirements concerning the provision of scheme information to shareholders, including the proposed obligation that it be clear, concise and effective.

ASIC could usefully provide guidance to scheme companies on these matters through a Regulatory Guide.

Corp Regs Schedule 8 Part 3

The Committee supports the removal of the specific checklist disclosure obligations in Corp Regs Schedule 8 Part 3, subject to its approach to directors' recommendations (see below) and the independent expert's report (see Section 4.5.3). The scheme company would still be subject to the general disclosure obligations under ss 411 and 412, including that the explanatory statement to shareholders must set out any previously undisclosed information that is within the knowledge of the directors of the scheme company and which is material to the making of a decision by shareholders whether or not to agree to the proposed scheme.

The Committee considers that the current obligation in Schedule 8 Part 3 for each director to indicate whether he or she recommends that shareholders accept or reject the scheme should be repealed.

The Committee recognises the strength of the argument that the current requirement for disclosure of the view of each director is out of step with the collective responsibility of the board in endorsing a scheme to be put to shareholders for approval. The rationale for requiring each director to give shareholders his or her view about a Chapter 6 takeover bid is less applicable to schemes, as a takeover bid does not come from the target company itself.

However, given the potential impact of a scheme on the future structure of a company and the rights of shareholders, dissenting directors should have the right to have their views included in the scheme documentation. This would allow such directors to convey any misgivings about a scheme to shareholders in a timely way before a vote is taken.

Supplementary disclosure

The directors of a company have a duty to disclose to shareholders before they vote on a scheme any information available to the company that was not included in the original disclosure document and that would be material to the shareholders' decision (other than information already reasonably available to shareholders, including through continuous disclosure).

Currently, supplementary disclosures of this nature are made pursuant to court order. This practice does not appear to pose a problem that would justify introduction of a prescriptive supplementary disclosure regime. The court, in exercising its discretion at the second court hearing whether to approve the scheme, can take into account the adequacy and accuracy of the information provided by the company to shareholders.

4.5.2 Liability for disclosure and defences

The Committee has considered the question whether the information supplied in scheme documents should be subject to a stand-alone liability and defence regime modelled on that applicable to bids.

The Committee notes that, for bids conducted under the Chapter 6 takeover provisions, both the bidder and the target have disclosure obligations, with liability for breach. There is no equivalent recognition in the scheme provisions that some of the information in the disclosure documents sent to shareholders may come from a third party, rather than from the scheme company.

The Committee notes that, in practice, companies that obtain information from third parties for inclusion in scheme documents seek warranties from those parties as to the accuracy of the information provided. Also, third parties who provide misleading information could be involved in any contravention of the disclosure requirements.[248]

The Committee is supportive of the principle of harmonization of liability and due diligence defences for information disclosures. These matters would usefully be considered in the context of all

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248 See, for instance, s 79 (involvement in contraventions).

disclosure documents and explanatory materials produced by companies (whether in relation to schemes, takeover bids, fundraising, buy-backs, capital reductions or other proposals), not just those for schemes. Accordingly, while acknowledging a case for changes to the liability provisions in the context of schemes, including the introduction of a due diligence defence, the Committee does not recommend such changes in relation to schemes alone. A broader review of these matters would be appropriate.

4.5.3 Standard for expert's opinion

The Committee favours retention of the requirements relating to the provision of a report on a scheme by an independent expert. Given the Advisory Committee proposal to remove many of the elements of the Corporations Regulations, this residual requirement might better be included in the Corporations Act itself.

The Committee considered whether the required standard for formulation of an expert's opinion for schemes should be more consistent with that for bids. The test for a scheme is whether it is in 'the best interests' of the shareholders, and for a bid whether it is 'fair and reasonable'.

In the Committee's view, there is no compelling case for having the same wording for schemes (even those that involve a change of control) and bids. There is case law on the meaning of the respective tests and the differences do not appear to create difficulties in practice. The formulation for bids may reflect the fact that, typically with bids, the key issue is essentially the price of the offer, whereas for schemes there may be other aspects that affect shareholders, for instance, their position in the restructured company or corporate group.

4.5.4 Summary of recommendations for change

The Committee recommends legislative amendment to:

- introduce a 'clear, concise and effective' requirement for scheme documents
- remove the specific disclosure obligations in Corp Regs Schedule 8 Part 3 and include the current requirements for an independent expert's report in the Corporations Act

- permit a director to require the scheme company to have his or her views on a proposed scheme circulated in the scheme documents sent to shareholders.

ASIC could usefully issue (in its Regulatory Guides) guidance to scheme companies in relation to incorporation of information by reference, including use of an information roadmap and publication of information on the website of the scheme company.

There is a case for harmonizing liability for disclosures in scheme documents, and defences, with comparable provisions of the Corporations Act, but this would better be considered in a broader review of corporate disclosure requirements.

5 Voting on schemes

This chapter outlines proposals for possible changes in voting by class and considers policy options in relation to the headcount test.

5.1 Class voting

5.1.1 Current position

A scheme requires approval by shareholders or, where there is more than one affected class of shareholders, by each of those classes. The principles for determining a class have been developed through judicial decision (refer Section 3.5.2 under the heading *the class voting system*). As explained in one judicial summary:

> (a) the essence of answering a question as to whether members of a corporation need to meet in separate classes and, if so, in what classes is an assessment of the similarity of the legal character of their rights and obligations as members and whether the impact of a scheme as proposed will affect those rights and obligations in a similar way;
>
> (b) in answering such a question, attention must necessarily be given to the effect of the proposed scheme on legal rights and entitlements, not on commercial interests;
>
> (c) it is to be remembered that the scheme is one between a company and its members. Thus, that some members might have divergent commercial interests which are strictly separate from their share membership is, at least in the ordinary course of events, nothing to the point insofar as any differentiation of member classes is concerned;
>
> (d) there is no requirement that there be identical interests as opposed to a similarity of interests as members. The question is one of the degree or rather the nature and extent of similarity rather than of the differences between members; and
>
> (e) if there is a sufficient similarity of legal interests in the way in which the members' interests will be affected by a

> scheme, it is not an impediment to those persons meeting in one class that many of them may have additional interests, in other words, interests which are over and above those which qualify them as members.[249]

A company has to determine whether it has classes of shareholders for the purposes of a scheme. It may seek directions on the proper constitution of classes from the court at the first hearing.[250] However, any directions are not binding on the court at the second hearing (which follows the meeting(s) of shareholders). Dissident shareholders at that second hearing may argue that the scheme should be disallowed on the basis that the classes were not correctly constituted.

5.1.2 Possible changes

First hearing

It has been suggested that the court should be given an express power, at the first hearing, to make a binding determination on the composition of classes or the relevance to the voting process of extrinsic interests.[251] It has been argued that this would add certainty to the shareholder meeting process and preclude these issues from emerging for judicial consideration only at the second court hearing, after the meetings.

An issue is whether shareholders would have a reasonable opportunity to be heard on an application to a court for a binding determination on class composition at the first hearing. One possibility is to require that shareholders be given advance notification of any application to this effect and an opportunity to make submissions.

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249 *Felix Resources Pty Ltd; in the matter of Felix Resources Pty Ltd (No 2)* [2009] FCA 1337 at [12].

250 See, for instance, *In the matter of Opes Prime Stockbroking Limited* [2009] FCA 813, where the Court at the first hearing determined that there were two classes of creditors for the purpose of a creditors' scheme of arrangement.

251 Damian & Rich, supra footnote 5, at [6.6]. The authors also note, at [12.16.1], that a similar proposal regarding a binding determination on the composition of classes at the first court hearing had been put forward in the UK, but was not included in the UK *Companies Act 2006*.

Second hearing

Another possibility is that the court be given an express 'curative' power at the second hearing to approve a scheme even if the classes have been wrongly constituted for the purpose of the vote by shareholders on the proposed scheme or if extrinsic interests exist which may otherwise result in the court overturning the scheme vote.[252]

Intending controller

A related question is whether the position of an intending controller in a change of control scheme should be clarified, by specifically disregarding any votes cast in favour of the scheme by that person or any associates of that person. Currently, it is expected that such persons either not vote or vote as a separate class.[253] A comparable voting exclusion applies in the context of bids.[254]

5.2 Headcount test

5.2.1 Current position

A scheme requires approval by shareholders under the voted shares test and the headcount test (see Section 2.3). The headcount test is a simple majority (50% plus one) of the registered shareholders (or each class of registered shareholders) who vote on the proposed scheme, either in person or by proxy.[255] Each participating shareholder has one vote, regardless of the number of shares held by that person.

The scheme provisions, as originally introduced in the United Kingdom in the 1860s and 1870s, only covered creditors' schemes, with the headcount test intended to provide 'a check on the ability of

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252 Damian & Rich, supra footnote 5, at [6.6]. The authors also note, at [12.16.1], that a similar proposal to give the court a power to sanction a scheme if classes had been wrongly constituted had been put forward in the UK, but was not included in the UK *Companies Act 2006*.

253 ASIC Regulatory Guide 60 at RG 60.94. See also the discussion of the class voting system in Section 3.5.2.

254 Subparagraph (a)(i) of Item 7 of s 611.

255 s 411(4)(a)(ii)(A). This provision refers to voting by members. Section 231 indicates that persons are members of a company only if their names appear on the register of members.

creditors with large claims to carry the day'.[256] The headcount test remained when the scheme provisions were extended to shareholders. The UK legislation retains the headcount test for both forms of scheme,[257] notwithstanding a recommendation in a report that it be abolished.[258]

The headcount test for schemes predated the development of statutory minority shareholder oppression remedies.

Prior to 2008, approval under the headcount test, as well as the voted shares test, was necessary for a scheme to proceed. The court's discretion was limited to either approving or rejecting a scheme that had been approved under both these tests.

An amendment, operative from 2008, retains the headcount test 'unless the Court orders otherwise'.[259] The voted shares test remains, as does the court's general discretion to reject or amend a scheme approved by shareholders.

The legislation does not qualify the discretion given to the court to dispense with the headcount test. However, the Explanatory Memorandum on the amendment indicated that the principal concern that it sought to address is the possibility of persons increasing their influence under the headcount test by share splitting:

> A members' scheme could be defeated by parties opposed to the scheme engaging in 'share splitting', which involves one or more members transferring small parcels of shares to a large number of other persons who are willing to attend the meeting and vote in accordance with the wishes of the transferor. By splitting shares to increase the number of members voting against the scheme, an individual or small

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256 The headcount test was included in the scheme of arrangement provisions in the *Companies Act 1862* (UK) ss 136–137, as clarified in s 411 of the *Joint Stock Arrangement Act 1870* (UK). This rationale for the original introduction of the headcount test was put forward by the UK Company Law Review Steering Group, *Modern Company Law for a Competitive Economy—Completing the Structure* (2000) at [11.34].

257 *Companies Act 2006* (UK) s 899(1).

258 *Modern Company Law: For a Competitive Economy—Final Report* (June 2001) at 278 [13.10]. See further Damian & Rich, supra footnote 5, at [12.16.1], which sets out extracts from the UK Parliamentary debates leading up to abandonment of the proposal to abolish the headcount test under the *Companies Act 2006*.

259 An amendment to s 411(4)(a)(ii)(A) adds the words 'unless the Court orders otherwise' at the beginning of that part of s 411.

> group opposed to the scheme may cause the scheme to be defeated. This may occur even though a special majority is achieved in terms of voting rights attaching to share capital, and if the share split had not occurred, the majority of members were in favour of the scheme.[260]

The Explanatory Memorandum added that:

> It is intended that the court would only exercise the discretion to disregard the majority vote under [the headcount test] in circumstances where there is evidence that the result of the vote has been unfairly influenced by activities such as share splitting, however the court's discretion has not been limited to allow for unforeseen extraordinary circumstances.[261]

The courts may disregard votes, or disallow a scheme, where share splitting has taken place.[262] Beyond that, the Explanatory Memorandum gives no guidance on what might constitute 'unforeseen extraordinary circumstances'. This may suggest a limited application of the court's dispensing powers beyond circumstances of share splitting.[263]

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260 para 4.179. Share splitting was considered in *MIM Holdings Ltd* [2003] QSC 181 at [19]. See also ASIC Regulatory Guide 60 at RG 60.97-RG 60.98.

261 para 4.181.

262 A court could reject a scheme, even though approved under the voted shares test and the headcount test, where approval under the headcount test had been achieved by share splitting: *Re MIM Holdings Ltd* (2003) 45 ACSR 559.
ASIC Regulatory Guide 60 at RG 60.98 states that:

> If we feel there is evidence that a scheme vote has been unfairly influenced by activities such as share splitting, we would generally advise a court to utilise its powers under s 411(4)(a)(ii)(A) to disregard the need for a majority vote.

In *Re PCCW Ltd* [2009] HKCA 178, the Hong Kong Court of Appeal declined to approve a scheme on the basis that share splitting had taken place. The Court observed, at [174], that:

> Where the result of the [share splitting] arrangements is to create a majority of registered shareholders voting in favour of the scheme, which would not have been obtained but for the arrangements, the court can, and should, when considering whether or not to give its sanction to the scheme, disregard the votes of such shareholders.

263 One possible 'extraordinary circumstance' may be where a single shareholder holds shares on behalf of a large number of beneficial owners. In *pSivida Ltd v New pSivida, Inc* [2008] FCA 627, the Court observed, at [11]-[12]:

5.2.2 Other instances of a headcount test

A headcount test applies in shareholder general meetings (in the absence of a poll) and in meetings of creditors in voluntary administration and liquidation. However, as explained below, the test serves a different purpose with meetings, and has a different effect in the specified types of external administration. A headcount test was removed from the compulsory acquisition provisions in 2000.

Shareholder general meetings

A resolution put to the vote at a meeting of shareholders is decided on a show of hands (headcount test), unless a poll is demanded.[264] A poll may be demanded on any resolution (with some limited exceptions).[265]

The headcount test in this context is designed to assist the progress of a meeting by allowing uncontentious resolutions to be passed without the formality of a poll. It does not provide an opportunity for persons with a small shareholding to block, or impose, a resolution contrary to the wishes of participating shareholders holding the majority of shares voted.

Voluntary administrations and liquidations

Creditors have a central role in deciding the future of a company in voluntary administration[266] and a lesser role in a liquidation.[267] They vote by number (headcount) as well as by the value of the corporate debt owed to them.[268] However, where the voting outcomes differ,

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> The fourth feature to which [Counsel] referred was that the ADS Depository holds its shares through ANZ Nominees Ltd on behalf of pSivida's many ADS holders who are United States residents. They account for approximately 388 million of the shares held by ANZ or approximately 53 per cent of the total shares issued. This may have consequences in relation to the headcount test imposed by s 411(4)(a)(ii) of the Act.
> This is not a matter which affects my discretion to convene a meeting of the shareholders of pSivida. However, it may become a relevant factor at the second court hearing. In that event, the plaintiff may seek to rely on the recent amendment to s 411(4)(a)(ii) which adds the words 'unless the court otherwise orders'.

264 ss 250J(1), 250L.
265 s 250K.
266 Corporations Act Part 5.3A, in particular Divisions 2, 5 (including s 439C) and 10.
267 For instance, ss 473(3)(b)(i), 477(2A), (2B), 497, 548.
268 Corp Reg 5.6.21(2), (3).

the administrator or liquidator may exercise a casting vote.[269] This ensures that a majority under, say, the headcount test cannot automatically block a proposal that is supported under the value test.

Abolition of headcount test for compulsory acquisitions

Prior to amendments in 2000, a headcount test, as well as a 90% entitlement test, had to be satisfied before a takeover bidder could compulsorily acquire remaining shares. The headcount test required that 75% of the persons who were entitled to accept the takeover offer had done so, irrespective of the number of shares they held.

The Advisory Committee report *Compulsory Acquisitions* (January 1996) recommended the abolition of the headcount test (and its replacement with the current 75% share acquisition test,[270] as well as the 90% entitlement test[271]), pointing out that a significant number of apathetic or untraceable shareholders could prevent satisfaction of the headcount test, even though, together, those shareholders may hold only a small fraction of the shares subject to the takeover offer.[272] The focus in both elements of the current test is on the number of shares, not the number of shareholders.

There is no headcount test in the alternative method of compulsory acquisition available outside a bid.[273] The Advisory Committee *Compulsory Acquisitions* report, on which these provisions are based, did not propose a headcount test in this context, for the same reasons that it favoured abolition of that test for compulsory acquisitions following a bid.[274]

5.2.3 Voting patterns in schemes

Any consideration of the headcount test for schemes needs to take into account how the test operates in practice.

There is no known instance where a proponent has succeeded under the voted shares test, but failed to obtain a majority under the headcount test.

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269 Corp Reg 5.6.21(4).
270 s 661A(1)(b)(ii).
271 s 661A(1)(b)(i).
272 [2.31]-[2.58], rec 7.
273 s 664A.
274 paras 10.1 ff.

There is, however, anecdotal evidence that in some cases a decision was taken not to embark upon a scheme because of the possibility of an adverse headcount vote.

Data on schemes entered into over the last ten years indicate that, on average, some 62% of shares have been voted on a scheme (under the voted shares test), but only some 22% of shareholders have voted (under the headcount test). In some instances, significantly less than 10% of shareholders have voted. This indicates that many, particularly small, shareholders did not participate in the voting process. It also indicates that, on average, a scheme would have failed under the headcount test if opposed by approximately 12% of a company's shareholders.[275]

5.2.4 Policy options for companies limited by shares

There are various possible ways to deal with the headcount test, ranging from its retention to its abolition, with or without other changes.

Option 1: no change

An argument for retaining the headcount test is that it gives small shareholders an opportunity to have an enhanced say in the restructuring of a company under a scheme. A company may need to tailor the terms of a proposed scheme to attract their support. In this way, the headcount test may reduce the possibility of schemes being oppressive to, or ignoring the interests of, minority shareholders. Also, a court can take into account a high approval rate under the headcount test, as well as under the voted shares test, in determining whether to approve the scheme.[276]

A contrary view is that the headcount test can place disproportionate power in the hands of small shareholders. It can result in a group of persons who together have contributed a small proportion of the company's equity capital having the capacity to block a scheme that is supported by shareholders who have contributed a much larger portion of equity. Although the court has a discretion to dispense

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275 The data on member voting patterns for 36 successful schemes entered into between 1998 and 2007 were supplied by Macquarie Bank.

276 See, for instance, *Re Simeon Wines Ltd* (2002) 42 ACSR 454, *Re Normandy NFM Ltd* (2003) 45 ACSR 236.

with the headcount test, uncertainty remains about the circumstances in which it would do so (the Explanatory Memorandum contemplated a court only doing so in response to share splitting or other 'unforeseen extraordinary circumstances': see Section 5.2.1). This may deter companies from proposing a scheme, given the time and cost involved in preparing the documentation and holding a shareholder meeting. By contrast, the outcome of a vote by shares may be easier to predict.

Option 2: expand the judicial dispensing power

The Law Council of Australia, in a submission on an Insolvency Bill (the Law Council 2007 submission),[277] submitted that, if the provision giving the court the power to dispense with the headcount test is retained (rather than completely removing the headcount test, as the Law Council would prefer: see Option 4), it should explicitly go beyond share splitting. The legislation might provide (for instance, in a note to the provision) that the court may consider exercising its discretionary power to dispense with the headcount test where there is evidence that, where a resolution has failed under the headcount test:

- a significant number of shareholders who voted against the scheme entered the body's register of shareholders after the announcement of the proposed compromise or arrangement [this point primarily deals with share splitting]

- a significant number of shareholders who voted against the scheme did so for reasons unrelated to their interests as shareholders of the body or, for any other reason, the results of the voting at the meeting do not necessarily represent the views of the shareholders as such

- one or more shareholders who supported the scheme held their shares on behalf of a significant number of beneficial owners of shares, or

- significant numbers of shareholders who voted against the scheme lacked a minimum economic interest, as shareholders, in the future of the company. For this purpose, in a listed company,

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277 Law Council of Australia Submission to Treasury on the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007.

a reasonable proxy for a minimum economic interest is a marketable parcel of shares.[278]

Option 3: retain, but modify, the headcount test

The Law Council 2007 submission noted two matters that could be dealt with by modifying, rather than eliminating, the headcount test. The submission was particularly concerned with the situation where a scheme was lost on the headcount test, yet:

- one or more shareholders who supported the scheme held their shares on behalf of a significant number of beneficial owners of shares, or

- significant numbers of shareholders who voted against the scheme lacked a minimum economic interest (marketable parcel of shares) as shareholders in the corporate future of the body.

It was suggested that the headcount test could be amended so that, rather than these matters being left to the discretion of the court:

- anyone voting on behalf of beneficial owners is entitled to vote, whether for or against the proposal, for the number of principals they represent (upon appropriate proof of the trust arrangement), and

- there is a minimum economic threshold for a valid headcount vote.

However, this raises a number of problems, including how to identify beneficial ownership and how to differentiate between genuine trust arrangements entered into for good commercial reasons and share splitting.

In regard to a minimum economic threshold, one possibility is to exclude from the headcount test shareholders who hold less than a marketable parcel of shares. Another possibility is a requirement that shareholders in the majority under the headcount test must, collectively, hold shares that are no less than a stipulated threshold,

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278 The ASX Listing Rules Chapter 19 and the ASX Market Rule Procedures Section 2.10 define a 'marketable parcel', being, in general, equity securities of a total market value of not less than $500.

say 10%, of the issued share capital. If that threshold is not reached, the outcome of the headcount test would be disregarded. In other circumstances, the court's discretion to dispense with the headcount test would remain.

Option 4: dispense with the headcount test

The Law Council 2007 submission argued that the headcount test for shareholders in schemes is an anachronism and should be abolished, leaving only the voted shares test and the requirement for court approval.[279]

The same submission suggested that the only argument for retaining the headcount test is that it ensures that a scheme will only take effect if it has been accepted by a majority of shareholders who vote on the scheme.

However, according to that submission, this consideration is outweighed by the following reasons for abolishing the headcount test:

- having to make a court application to dispense with the headcount test involves time, cost and uncertainty[280]
- other provisions dealing with shareholder meetings are based upon the principle of 'one share one vote'[281]
- as nominees hold a large portion of shares in some listed companies, the headcount test is not indicative of the views of the beneficial owners of the shares. The headcount test focuses on registered holders of shares rather than underlying ownership, and thus a nominee only counts as a single member under the test. The headcount test in effect disenfranchises investors who invest in Australian companies using depository mechanisms such as American Depository Receipts. By contrast, under the voted shares test, the nominee may be directed to vote in

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279 The Law Council also pointed out that abolishing the headcount test would require a technical adjustment to the voted shares test so that it applies to all Part 5.1 bodies, not just those with share capital.

280 The time and cost involved may depend on whether an application to the court to dispense with the headcount test is considered at the first court hearing, at the second court hearing, or as an independent intermediate application.

281 However, the possibility of non-voting shares in listed companies has been mooted.

different ways by various beneficial owners, as the nominee is able to vote each share separately[282]

- the CLERP reforms removed the comparable headcount test in the compulsory acquisition provisions for takeovers, as recommended by the Advisory Committee.[283] The reason for the legislation was that it 'would overcome the potential problem of a single shareholding being distributed among several people to deliberately increase the number of shareholders able to oppose the bid'.[284] This policy reason applies equally to schemes of arrangement.

Another argument for removing the headcount test is that the court in any event has a general discretionary power to approve or reject a scheme, taking into account the interests of affected parties. This judicial power could be used to reject a scheme that is seen as unfairly prejudicial to the interests of small shareholders, even in the absence of a headcount test (see Section 3.5.2 under the heading *general court discretion*).

If further specific guidance is considered necessary, a note or provision could be included in the legislation to the effect that, in exercising its discretions under s 411(4)(b) or s 411(6) whether to approve a scheme, the court should take into account whether the scheme's impact on small shareholders is fair and reasonable, in the context of its overall commercial purpose and effect. This would overcome any suggestion that removal of the headcount test was intended to reduce or qualify the general principles of fairness that have been applied by the court.

One possible concern with having only a voted shares test is that a dominant shareholder who is the sponsor or beneficiary of the scheme could use its voting power to all but ensure that the threshold of 75% of votes cast is reached. However, under established

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282 s 250H.

283 *Compulsory Acquisitions* (January 1996) rec 7.

284 Corporate Law Economic Reform Program—Proposals for Reform, Paper No 4, *Takeovers—Corporate control: a better environment for productive investment* (1997) at 28. See also para 7.35 of the Explanatory Memorandum for the Corporate Law Economic Reform Program Bill 1998. According to the submission from the Law Council of Australia, the decision of the Takeovers Panel in *Re Prudential Investment Co of Australia Ltd* (2003) 49 ACSR 147, which dealt with an instance of apparent share splitting, highlights the merits of this reform.

principles, this shareholder would have to vote in a separate class meeting (see Section 3.5.2 under the heading *the class voting system*). Any doubt on this matter could be overcome by a specific provision to the effect that any votes cast by a person whose proportionate share or voting entitlement will increase under the scheme, and any associates of that person, should be disregarded (compare Section 5.1.2 under the heading *Intending controller*).

Option 5: dispense with the headcount test but modify the voted shares test

On one view, removal of the headcount test (Option 4) could be balanced by imposing a higher threshold for the voted shares test.

A change of this nature could take a number of forms, such as:

- a requirement for a 'super-majority' (say, 90%) of the shares voted on the resolution, and/or
- a participation threshold, namely that at least a certain proportion of the issued shares (say, 50%) has been voted on the proposal.[285]

The first alternative would ensure that a scheme cannot be approved without a high level of support by participating shareholders. The second alternative would ensure that the voted shares represent a majority of the issued share capital, though it could reduce one of the main advantages of schemes, that their success is not jeopardised by the non-participation of uncontactable, apathetic, or other uninvolved shareholders.

5.2.5 Policy options for companies limited by guarantee

Most companies that undertake schemes are limited by shares. However, companies limited by guarantee have members, but no issued share capital.[286] In consequence, a scheme for a company

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285 The New Zealand Takeovers Panel has proposed, in addition to the voted shares test, and in lieu of the headcount test, a requirement for approval of 'more than 50% of the total voting rights of the company'.

286 See s 112(1) and s 9 definition of 'company limited by guarantee'. There is no current provision in the Corporations Act for registering companies limited by both shares and guarantee, though existing companies with this structure are still recognised: s 1378(2)(g).

limited by guarantee only requires the approval of a simple majority of members voting on the scheme, under the headcount test. There is no voted shares test.[287] However, if the scheme involves matters that require a special resolution, such as an amendment to the company's constitution, approval by a 75% majority of members who vote is also required.[288]

Removal of the headcount test would leave these companies without a mechanism for member approval of schemes. Some other provision would need to be made. One commentator has proposed an amendment whereby a scheme involving a company limited by guarantee would require the approval of 75% of the members who vote on the resolution, rather than the existing simple majority.[289]

5.3 Submissions

5.3.1 Class voting

Binding class determinations

The Committee invited submissions on whether the court should be given an express power, at the first court hearing, to make a binding determination on the composition of classes or the relevance to the voting process of extrinsic interests and, if so, whether shareholders should be given advance notification of an application to this effect and an opportunity to make submissions.

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287 The headcount test in s 411(4)(a)(ii)(A) would apply, but not the voted shares test under s 411(4)(a)(ii)(B), given that a company limited only by guarantee has no share capital, and the voted shares test only applies 'if the body has a share capital'. See *Re MBF Australia Ltd* [2008] FCA 428 at [31] and the cases referred to therein. In *Re NRMA Ltd* (2000) 33 ACSR 595 at [49], para 1.3, Santow J noted, in relation to a number of interrelated schemes, that:

> The scheme resolutions require merely a majority in number of the members present and voting as being companies limited by guarantee, they have no share capital.

288 s 136(2), s 9 definition of 'special resolution'.

289 G Durbridge, *Commentary on Tony Damian's Paper on Reforming the Scheme Provisions* (Law Council of Australia, Business Law Section, Corporations Workshop July 2005). He suggests that this result could be achieved simply by removing from s 411(4)(a)(ii)(B) the introductory phrase 'if the body has a share capital'. Each member of a company limited by guarantee would have one vote.

A number of submissions favoured the court having this power, arguing that it would add certainty and reduce completion risk.[290] One view was that, as there is usually a considerable period between the initial announcement of a scheme and the first court hearing, shareholders could be given adequate advance notification of the application.

Other submissions[291] opposed such a power in the court, arguing that there is likely to be an imbalance of information between the shareholders and the company at the first hearing, to the possible disadvantage of shareholders seeking to challenge an application for a class determination.

Some respondents[292] favoured giving the court an express 'curative power' at the second court hearing to approve a scheme where the classes may have been wrongly constituted, arguing that this approach would increase flexibility and efficiency.

Intending controller

The discussion paper raised the question whether the position of an intending controller in a change of control scheme needs any clarification to ensure that any votes cast in favour of the scheme by that person and any associates of that person are disregarded.

One view was that the class composition test already prevents an intending controller and its controlled entities from voting with other shareholders as part of one class.[293]

5.3.2 Headcount test for companies with share capital

The discussion paper raised the question whether the headcount test should be retained, amended in some form, or repealed, for companies with a share capital.

Two submissions[294] favoured retaining the headcount test, arguing that it compels the scheme proponent to consider the interests of

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290 ASIC, Law Council of Australia, Law Society of NSW, Minter Ellison, RiskMetrics.
291 Allens Arthur Robinson, Australian Shareholders' Association, Wee & Nehme.
292 Allens Arthur Robinson, ASIC, Wee & Nehme, Law Council of Australia, Law Society of NSW, RiskMetrics.
293 Allens Arthur Robinson.
294 Minter Ellison, RiskMetrics.

smaller shareholders. In their view, the test provides minority shareholders with a desirable measure of protection.

Other respondents[295] favoured removal of the headcount test, arguing that it is inconsistent with the economic precept of one share one vote. The court's general discretion to refuse approval of a scheme is a more effective means of protecting small shareholders in appropriate circumstances.

5.3.3 Voted shares test for companies with share capital

The discussion paper raised the question whether, if the headcount test for companies with a share capital is removed, there should be a compensating change in the voted shares test (75% of the votes cast on the resolution), such as a 90% 'super majority' requirement.

One respondent,[296] in arguing for retention of the 75% voted shares test in its current form, pointed out that, in practice, the voted shares threshold for a scheme may be difficult to satisfy, given that the number of shareholders who vote usually represents significantly less than 100% (commonly 50% to 70%) of the total votes. A 10-15% holding by a hostile shareholder, or a combination of hostile shareholders, may suffice to block approval of a scheme.

5.3.4 Headcount test for companies limited by guarantee

There was a general recognition in submissions of the need to keep the headcount test for companies limited by guarantee, given that these companies have members but no issued share capital. A voted shares test cannot be applied to these companies.

Submissions were invited on whether a scheme for these companies should retain the simple majority headcount test, or require the approval of 75%, or some other figure in excess of a simple majority, of the members who vote on the resolution.

Some respondents were of the view that the voting requirement for companies limited by guarantee should be amended to 75% of

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295 Allens Arthur Robinson, Australian Shareholders' Association, Law Council of Australia, Wee & Nehme, Law Society of NSW, Finsia. See also Damian & Rich, supra footnote 5, at [4.3.5].

296 Allens Arthur Robinson.

members who vote on the resolution.[297] This would ensure that a scheme is approved only if supported by an overwhelming majority of members who choose to vote.

Other submissions[298] favoured no change to the current approval requirements for approval of a members' scheme for a company limited by guarantee. One of those submissions[299] said that the simple majority test provides greater flexibility for schemes that do not involve matters that require a special resolution.

5.4 Advisory Committee position

5.4.1 Class voting

Binding class determinations

The Committee does not agree that the court should be given the power to make binding determinations on class composition at the first hearing. The court should retain the flexibility to review the question of class voting, including the power to decide at the second hearing that classes were inappropriately constituted. Some issues relevant to class composition may come to light after the voting by shareholders has taken place (for instance, that persons voting in favour of a scheme are associates of a person seeking control of the company under the scheme). In these circumstances, the court should not be constrained by an earlier determination on class composition.

The preferable approach is to give the court an express curative power to approve a scheme at the second court hearing, even if the classes were wrongly constituted or if extrinsic interests exist that might otherwise result in the court overturning the scheme vote. The court has a somewhat similar power under s 1322. In deciding whether to make an order under the proposed curative power, the court could take into account the possibility of disadvantage to any person.

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297 Law Council of Australia, Law Society of NSW.
298 Minter Ellison, Abacus – Australian Mutuals.
299 Abacus – Australian Mutuals.

Intending controller

The discussion paper raised the question whether the position of an intending controller in a change of control scheme needs any clarification to ensure that any votes cast in favour of the scheme by that person and any associates of that person are disregarded.

The Committee agrees with the view in submissions that the class composition test already precludes an intending controller and its controlled entities from voting with other shareholders as part of one class. There does not appear to be a need for legislative clarification.

5.4.2 Headcount test for companies with share capital

The Committee recommends the removal of the headcount test for the approval of schemes. While the test might be seen as adding to the protection of small shareholders (for whom some implications of a scheme may differ from those for larger shareholders), it has the potential to result in the blocking of a scheme even where the holders of the overwhelming number of shares in the company have voted in favour. Also, the headcount test does not accommodate the situation where there are multiple beneficial owners behind a single legal owner of shares.

The Committee considers that decisions on fundamental corporate matters should ultimately be determined by the shares voted, rather than the number of shareholders. This is already the case with other changes to a company that may fundamentally affect shareholders. These include changes to a company's constitution and other important matters that call for approval by special resolution. The approval requirement for a special resolution, 75% of shares voted, is the same as the threshold test for schemes.

Small shareholders have other protections, such as the duties of directors to act in the interests of shareholders generally in proposing the scheme, the requirement for shareholders to vote in separate classes where their interests differ, the requirement for an expert's opinion, the role of ASIC in reviewing the terms of a scheme and the discretion of the court in approving a scheme. It is also open to minority shareholders to approach ASIC or the court if they are concerned that their interests are being unduly prejudiced.

The Committee recognises that removal of the headcount test could be seen as making schemes more attractive than bids in some circumstances. However, as discussed in Chapter 3, there is a range of factors to take into account in determining whether to proceed by way of a bid or a scheme. Also, as indicated above, the Committee considers that the 75% voted shares test is in line with the voting threshold for other important corporate decisions and is appropriate for schemes.

5.4.3 Voted shares test for companies with share capital

The Committee is not persuaded of a need to change the voted shares test if the headcount test is abolished. There was no strong call for change by respondents. The current approval threshold (75% of shares) is in line with that for other significant changes to the company, such as amendments to the constitution and other matters that call for a special resolution. Dissenting shareholders have the opportunity to express their views at the shareholder meeting and to raise their concerns at the second court hearing. Also, as pointed out in submissions, a minority of hostile shareholders may have the voting power in some circumstances to defeat a scheme proposal. A requirement for a higher approval threshold, say 90% by value of shares voted, would constitute a significant impediment to the implementation of schemes, for no good purpose.

5.4.4 Headcount test for companies limited by guarantee

As recognised in submissions, there is a need to keep a headcount test for companies limited by guarantee, given that these companies have members but no issued share capital. A voted shares test cannot be applied to these companies.

The Committee notes the arguments for raising the voting threshold, but does not consider that they provide a compelling reason for changing the current requirement of a simple majority for companies limited by guarantee.

5.4.5 Summary of recommendations for change

The Committee recommends that:

- the court be given a curative power to approve a scheme at the second court hearing, having regard to all the circumstances, even if the classes have been wrongly constituted or if extrinsic interests exist that might otherwise result in the court overturning the scheme vote

- the headcount test for companies with share capital be abolished.

6 Regulatory and judicial supervision

This chapter considers whether ASIC should have modification powers for schemes comparable to those for takeover bids, and whether s 411(17)(a) or s 411(17)(b) should be repealed or amended.

6.1 ASIC exemption and modification powers

ASIC has a limited range of dispensing and consent powers in relation to a proposed scheme, confined to the disclosure requirements.[300] By contrast, it has broad powers under Chapter 6 of the Corporations Act to exempt or modify many of the prescriptive requirements for takeover bids.[301]

Commentators[302] have suggested that ASIC's scheme powers be broadened in a similar manner to its powers under Chapter 6 for takeover bids. This also raises the question whether any appeal from ASIC's exercise of those powers should be to the Administrative Appeals Tribunal or to the Takeovers Panel.[303]

A contrary view is that the ASIC exemption and modification powers under the bid provisions reflect the need to add flexibility to the detailed and complex takeover provisions, which in some cases could operate in an inappropriate and unintended manner. By contrast, the scheme procedural provisions are not of the same level of complexity or likely to have perverse results that would call for equivalent ASIC general exemption and modification powers.

One possibility is to give ASIC the power to exempt companies within a wholly-owned corporate group from having to comply with

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300 Corp Reg 5.1.01 and Corp Regs Schedule 8 Part 3, rule 8305. See further ASIC Regulatory Guide 60 at RG 60.85-RG 60.86.

301 s 655A. In exercising those powers, ASIC must have regard to the Eggleston principles in s 602 regarding the regulation of bids.

302 Damian & Rich, supra footnote 5, at [5.10.1].

303 In general, appeals from ASIC's exercise of its exemption or modification powers are to the Administrative Appeals Tribunal (s 1317B). However, in regard to bids, the appeal rights are to the Takeovers Panel (ss 656A, 1317C(ga)).

the shareholder disclosure requirements when effecting a merger or other form of corporate reorganization within that group by way of a scheme, given that all the shares are held by the parent company.

However, an ASIC exemption power of this nature may be unnecessary if a short-form merger procedure for wholly-owned corporate groups that would not require shareholder approval is introduced (Section 7.3).

6.2 Purpose and comparable protections tests

The court has a general protective role in determining whether to approve a scheme (see Chapters 2 and 3). One aspect involves the operation of s 411(17), which provides that a court not approve a scheme unless it is satisfied that the scheme has not been proposed for the purpose of avoiding the Chapter 6 bid provisions or ASIC has stated that it does not object to the scheme.

6.2.1 Background

In the 1970s and the early 1980s, when the takeover laws as we know them today were being formulated, there was an issue whether schemes were an appropriate alternative procedure to bids to achieve a change of control.

The interrelationship between scheme and bid provisions as means of achieving a change of corporate control was examined in a number of cases. The courts in those cases accepted schemes as an alternative to a bid for this purpose.[304]

In policy debates that followed from those cases, one view was that all change of control transactions should proceed through a bid,

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[304] In *Re The Bank of Adelaide (*1979) 4 ACLR 393, which involved a proposed share cancellation scheme to achieve a change of control, the Court rejected the proposition that all change of control transactions must proceed via a bid. The Court (at 421) considered that the bid provisions were particularly appropriate for hostile bids:

> Part VIB [the bid provisions], as I read it, is plainly aimed at the intrusive or aggressive style of take-over where the operation is initiated by an invader company against a target company, and the latter company and its directors assume the character of a town under siege.

Likewise, in *Re Wallace Dairy Co Ltd* (1980) 5 ACLR 139, the Court held that a change of control through a share cancellation proposal could proceed under a scheme.

thereby achieving a uniformity of approach. This approach would overcome any possibility of regulatory arbitrage whereby a person seeking corporate control might choose a scheme because of the perceived easier shareholder approval threshold or to avoid the equality of opportunity or other regulatory protections in the takeover laws.

A contrary view at that time was that it was impractical to force all change of control transactions through the bid mechanism, particularly where a more complex corporate reorganization was involved. Such an approach might simply encourage resort to structures or devices that could not be part of a takeover bid and would therefore call for the use of a scheme. Also, in considering whether to approve a change of control scheme, a court would be mindful of any lesser level of protection for shareholders under the scheme than they would have had under a bid.

The outcome has taken the form of what is now s 411(17).[305] The court may not approve a scheme unless either it is satisfied that the scheme is not for the purpose of avoiding the bid provisions (s 411(17)(a)) or ASIC has provided a 'no objection' statement (s 411(17)(b)). Both matters do not have to be satisfied: an ASIC no objection statement precludes the court from exercising its power under s 411(17)(a). However, in exercising its general discretion whether to approve a scheme,[306] the court may give consideration to the purpose of the scheme.[307]

As indicated earlier (Section 3.4.2 under the heading ***Purpose and comparable protections***), s 411(17) has been interpreted by the courts, and applied by ASIC, in a manner that does not preclude the use of schemes to achieve a change of control. Persons seeking to achieve control of a company may choose a scheme over a bid, at least where there is some commercial justification for that choice

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305 Damian & Rich, supra footnote 5, in Chapter 10, set out the legislative history of s 411(17), leading up to and including its first forerunner in s 315(21) of the *Companies Act 1981* (Cth) and a corresponding provision in State and Territory laws.

306 s 411(4)(b), (6).

307 See footnotes 130 -132.

and the target company is prepared to put the change of control proposal to a shareholders' meeting.[308]

6.2.2 Proposal to repeal s 411(17)

Commentators have argued that the power of the court to withhold approval of a scheme pursuant to s 411(17) creates an undue 'completion risk' and that the section should be repealed:

> the Courts have decided on many occasions that a scheme of arrangement is an appropriate mechanism for effecting a change of control transaction. This position has also been adopted by ASIC and the Takeovers Panel. However, the precise operation of s 411(17) (and, in particular, paragraph (a) of that subsection) today remains a source of lingering uncertainty and adds an unquantifiable and unacceptable element of completion risk to any scheme of arrangement. This is made all the more objectionable because whether or not s 411(17) will, in fact, pose completion difficulties in a particular scheme will not be known until the final court hearing (that is, after the great time and financial expense of undertaking the scheme process has been incurred).[309]

They also argue that:

> Schemes serve a very useful role in the market for corporate control and there are comprehensive protections and safeguards for dissentients and minorities inherent in the scheme process. At the very minimum, Part 5.1 of the Corporations Act 2001 (Cth) should have excised from it the single provision that casts a shadow (however faint) over the ability of merger participants to use the scheme procedure to effect a control transaction.[310]

They suggest that, in addition to repealing s 411(17), a purposive statement be introduced into the scheme provisions acknowledging that schemes can be used to change control. The result would be:

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308 See also Damian & Rich, supra footnote 5, Chapter 11, on the interpretation and application of s 411(17).
309 Damian & Rich, supra footnote 5, at [15.2.1].
310 ibid.

> an explicit acceptance of the use of the scheme procedure to effect change of control transactions, unfettered by the threat of intervention on takeover avoidance grounds.[311]

Another commentator has questioned what practical function s 411(17) serves, given that no court has rejected a scheme under that provision and that in practice it is relatively easy for promoters of a change of control to provide reasons for proceeding by way of a scheme rather than a bid.[312]

It has been argued that technical 'equality of opportunity' rules applied in the bid provisions (see Section 3.4.1) and other restrictions on bids, such as the prohibition on conditions requiring payments to officers of the target[313] or self-activated defeating conditions,[314] would be inappropriate for schemes, as:

> in the scheme context, it is the combination of the class voting tests, along with disclosure of all material information and the Court's fairness discretion, which ensures that there is a fully informed disinterested vote where the equality of opportunity principle would otherwise be compromised.[315]

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311 ibid.

312 AJ Papamatheos, 'Avoidance of takeover laws: manufacturing reasons for a scheme of arrangement' (2006) 19 *Australian Journal of Corporate Law* 216. A similar observation on the ease of satisfying the court that a scheme has not been proposed to avoid the takeover provisions was made by N Pathak, '"Public to private" takeover bids' (2003) 21 *Company and Securities Law Journal* 295 at 308.

313 s 628.

314 s 629.

315 T Damian, *Bidding farewell to Everest: Reforming the scheme provisions* (Law Council of Australia, Business Law Section, Corporations Workshop July 2005) at 19. In the context of collateral benefits, for instance, that author argues (at 20-21) that any target shareholders who receive a collateral benefit could be placed in a separate class for voting purposes, or the court, at the second hearing, could discount or disregard their votes on the basis of an extrinsic interest. Likewise, in regard to the same offers rule, the author argues (at 23) that:

> Even if the target board, the independent expert and the Court could be convinced of the merits of an arrangement under which certain shareholders were to be treated differently, the body of 'disinterested' shareholders receiving a proposal on less advantageous or even just different terms would, in appropriate circumstances, be protected by a separate class vote or the discounting of votes on the basis of extrinsic interests.

The author undertakes a similar analysis in regard to the minimum bid price rule (at 21-22), acquisitions outside the bid rule (at 23) and escalation agreements (at 23-24).

See also Damian & Rich, supra footnote 5, at [15.2.2].

In the leading case of *Re Ranger Minerals Ltd* (2002) 42 ACSR 582, the Court approved a scheme, even though the minimum bid price principle applicable to bids would not have been satisfied, in that the intending controller had acquired shares of the company in the four months prior to the scheme at a higher price than that provided for under the scheme.[316] The Court noted that these pre-scheme purchases had been adequately disclosed in the explanatory statement to shareholders and had been considered in the independent expert's report and that:

> The circumstances of, and reasons for, that past acquisition and the justification offered by the propounders of the scheme for the consideration then paid, can be assessed by shareholders, who should be in a sound position to see for themselves whether they are disadvantaged by inequality of treatment (at [45]).

A similar approach was taken in a later decision where the same issue arose.[317]

The proposed repeal of s 411(17) would affect the objection rights of ASIC under s 411(17)(b). One commentary acknowledges this consequence:

> One consequence of the repeal of s 411(17) would be to remove the ability of ASIC or an objector to complain about a scheme on the grounds that it achieves a result that would have been prohibited under Chapter 6. … Thus, the existence of collateral benefits, the minimum bid price rule and self-defeating conditions in a scheme would no longer open the door to complaint by ASIC or an objector on takeover avoidance grounds.[318]

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316 Subsection 621(3) provides that, under a bid, the minimum bid price must equal or exceed the maximum price that the bidder or an associate paid, or agreed to pay, for the bid class securities during the four months before the date of the bid.

317 In *Anzon Australia Limited* [2008] FCA 309 at [10]-[14], the Court noted, at the first court hearing, that there was no equivalent in the scheme provisions of the minimum bid price principle in s 621(3). However, the Court gave orders for the holding of a shareholders' meeting, noting that, according to the independent expert's report, the consideration offered under the proposed scheme exceeded the fair market value of the shares, and the shareholders were fully informed of the circumstances that may have constituted a departure from the equality of opportunity rules applicable to bids.

318 Damian & Rich, supra footnote 5, at [15.2.1].

However, the same commentary argues that ASIC would still have a role in regard to matters specifically regulated by the scheme provisions or coming within the general exercise of the court's discretion under s 411(4) and s 411(6):

> A complaint on the grounds of, say, inadequate disclosure, class composition, extrinsic interests or fairness would, of course, remain open to ASIC and objectors.[319]

6.2.3 Arguments for retaining s 411(17)

On one view, the repeal of s 411(17)(b) might be seen as materially reducing ASIC's role in reviewing schemes, and therefore the level of protection for shareholders, albeit that ASIC can still intervene at the court approval stage, pursuant to its general powers.[320]

The ASIC 'no objection' statement may provide the court with a degree of assurance that ASIC has considered the matters set out in ASIC Regulatory Guide 60, including the application of the Eggleston principles (s 602),[321] so that shareholders in a scheme receive equivalent, though not necessarily identical, treatment and protection as under a bid.

6.2.4 Proposal to amend s 411(17)

One commentator[322] has suggested rewording s 411(17) specifically to include the Eggleston principles (s 602) for change of control schemes, rather than adopt technical equality of opportunity or other procedural rules drawn from the bid provisions (see Section 3.4.1). The intention is to provide a more explicit basis for current practice under this provision.

This proposed rewording of s 411(17) would replace the takeover avoidance purpose test and the ASIC 'no objection' statement:

> I would state the objectives expressly: the court should not approve a scheme of arrangement in the nature of a takeover (and perhaps any scheme which eliminates or consolidates a

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319 ibid.
320 s 1330.
321 ASIC Regulatory Guide 60 Section B.
322 G Durbridge, *Commentary on Tony Damian's paper on reforming the scheme provisions*, Law Council of Australia, Business Law Section, Corporations Workshop July 2005.

> class of security–holders) if it departs without good reason from section 602 [the Eggleston principles], in relation to the scheme company or in relation to any downstream or upstream company to which Chapter 6 applies and in which someone will acquire a substantial interest as a result of the scheme being implemented. Nothing less will give reasonable substance to the principle of harmonious, practical and mutually supportive operation [of the scheme and bid provisions], and anything more may unduly inhibit the development of schemes.

ASIC, or any other interested party, would be able to make submissions to the court on this matter.

The commentator further proposes that, to facilitate the consideration of the scheme and its documentation under such a redesigned general Eggleston provision, a scheme company should be required, possibly by regulation or rule of court, to give ASIC and the court a further statement, which should:

> (a) show how the scheme deals with the basic structural issues of equal treatment, appropriate differential treatment within classes and fairness as between classes of holders of shares and of securities convertible into shares
>
> (b) list all actual and proposed acquisitions of shares or securities convertible into shares in the scheme company by the acquiring party under the scheme and within the previous four months, with a full disclosure of terms, a reconciliation of prices and an explanation where people with similar interests are treated differently
>
> (c) list all substantial holdings in the scheme company and any relevant agreement between the acquiring party and a substantial holder which is collateral or otherwise relevant to the scheme or the takeover, and
>
> (d) list all associates of the acquirer who hold securities in the relevant class and say to what classes they have been allotted.[323]

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[323] ibid.

To ensure full disclosure, the commentator also suggested that:

> As well as the scheme and the scheme company, this statement should cover any transaction on which the scheme is conditional or otherwise depends, and consequential acquisitions of securities in companies other than the scheme company.[324]

The commentator also observed that a disclosure obligation of this nature:

> is both a test of equal treatment and absence of collateral benefit and a check for the inappropriate use of the 75% majority, such as to outflank someone with a blocking stake.[325]

6.3 Submissions

6.3.1 ASIC exemption and modification powers

The Committee invited submissions on whether ASIC should be given expanded, or general, exemption and modification powers for the scheme provisions, comparable to those it has for bids.

Some submissions[326] favoured conferral of general exemption and modification powers on ASIC in relation to the scheme provisions. Some of those respondents[327] said that this should especially be the case if any changes to the scheme provisions resulted in additional prescription. Other submissions[328] saw no need for ASIC to have additional powers.

6.3.2 Purpose and comparable protections tests

Anti-takeover avoidance

Submissions were invited on whether the anti-takeover avoidance provision, s 411(17)(a), should be retained in its present form, repealed, or otherwise amended.

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324 ibid.
325 ibid.
326 Allens Arthur Robinson, Australian Shareholders' Association, Law Council of Australia.
327 Allens Arthur Robinson, Law Council of Australia.
328 Wee & Nehme, Law Society of NSW.

Some respondents[329] argued that, to overcome the possibility of 'regulatory arbitrage' between schemes and bids, s 411(17)(a) should be amended, either to prevent schemes of arrangement from being used in lieu of takeovers for change of control transactions or to limit the scheme provisions to complex transactions that cannot reasonably be effected by way of a Chapter 6 takeover bid.

A number of submissions[330] favoured repeal of s 411(17)(a). Arguments put forward included that:

- schemes and takeover bids are legitimate alternative procedures for effecting a change of control, offering different protections for shareholders, but comparable in their outcome
- repeal would minimise uncertainty and completion risk
- repeal would overcome the need to include a 'no unacceptable circumstances' declaration in the scheme explanatory statement.[331]

Some of these respondents also favoured inclusion of a purposive statement that a scheme may be used for a transaction that could have been effected under Chapter 6. These amendments would be 'the final step towards an explicit acceptance of the use of the scheme procedure to effect change of control transactions, unfettered by the threat of intervention on takeover avoidance grounds'.[332]

Eggleston principles

Submissions were invited on whether s 411(17) should be reworded specifically to include the Eggleston principles (s 602) for change of control schemes.

Some respondents[333] said that s 411(17) should be amended to require change of control schemes to comply with the Eggleston principles (unless the court approves a departure for good cause), arguing that this would:

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329 Finsia, Australian Foundation Investment Company Ltd.
330 Allens Arthur Robinson, Corrs Chambers Westgarth, Law Council of Australia, Minter Ellison. See also Damian & Rich, supra footnote 5, at [15.2.1] and [15.2.2], which includes a table of the relative protections under bids and schemes.
331 Damian & Rich, supra footnote 5, at [15.2.3].
332 Damian & Rich, supra footnote 5, at [15.2.1].
333 Wee & Nehme, Law Society of NSW, RiskMetrics, Finsia.

- reinforce the protection for minority shareholders
- reduce uncertainty
- ensure consistency with the takeover provisions.

Other respondents opposed any mandatory application of the Eggleston principles to schemes.[334] Arguments put forward included that:

- schemes have protections equivalent to those in takeover bids, including the class voting test, the requirement for disclosure of all material information and the court's general fairness discretion to approve or reject a scheme
- adoption of the Eggleston principles could reduce the flexibility of schemes and would likely have unintended consequences.

ASIC role

Submissions were invited on whether the role of ASIC under s 411(17)(b), being its right to lodge at the second court hearing an objection or no objection statement, should be retained in its present form, be repealed, or otherwise be amended.

Some respondents were of the view that s 411(17)(b) is unnecessary, given ASIC's other powers, including to examine the proposed explanatory statement for a scheme before the first court hearing (s 411(2)), to make submissions on the proposed arrangement and the explanatory statement at the first court hearing (s 411(2)(b)(ii)), and to intervene at the second court hearing, pursuant to its general power to intervene in judicial proceedings (s 1330).[335]

Other submissions[336] favoured retention of ASIC's role under s 411(17)(b), arguing that:

- it protects retail shareholders

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334 Law Council of Australia, Minter Ellison, Allens Arthur Robinson. See also Damian & Rich, supra footnote 5, at [15.2.4] under the heading *(b) The Eggleston principles*.

335 See, for instance, Corrs Chambers Westgath. See also the general comments of Damian & Rich, supra footnote 5, at [15.2].

336 Australian Shareholders' Association, ASIC, Wee & Nehme, RiskMetrics.

- ASIC has an important role in ensuring that applications that come before the court are fair by reviewing proposed schemes and advising the court that it has no objection
- its abolition could reduce ASIC's role in reviewing schemes, to the detriment of minority investors.

One of those respondents[337] said that ASIC should be given more time to prepare its statement that it has no objection to a scheme.

6.4 Advisory Committee position

6.4.1 ASIC exemption and modification powers

The Committee does not see a need to expand ASIC's exemption and modification powers in relation to a proposed scheme, having regard to ASIC's current role in the scheme approval process, the role of the court, and the absence of any proposals that would increase the complexity of the scheme process.

6.4.2 Purpose and comparable protections tests

Anti-takeover avoidance

As a matter of general approach, the Committee is neutral on the question whether changes of corporate control should proceed by a scheme or by a bid in circumstances where either procedure would be open. In some circumstances, a scheme is needed in order to accomplish other changes associated with the change of control. In hostile circumstances, a bid would be the only way open.

Bids and schemes have their own procedural protections. Given developments in judicial interpretation of s 411(17)(a) and the demonstrated demand in the market for effecting change of control transactions through schemes as well as bids, the provision fulfils no real purpose. It should be repealed. Also, given those developments, the Committee does not see a need to go further and provide a purposive statement, as suggested by some respondents.

337 RiskMetrics.

Eggleston principles

The Committee does not see a need to mandate the Eggleston principles in s 602 for schemes. These principles were developed in the context of Chapter 6 bids, to protect shareholders where a bidder can bypass the directors of the target company and make an offer directly to them. They are not necessarily appropriate in the context of schemes, even where control may be at stake. A scheme proposal comes from the company itself, whose directors have a duty to act in the best interests of the company in putting forward the scheme, and both the court and ASIC have a protective role. The fact that a scheme and a bid may have a similar ultimate outcome does not necessarily mean that the same form of protection is required.

ASIC role

The role of ASIC in reviewing schemes and in providing an objection or no objection statement at the second court hearing is useful and should be retained.

As previously indicated (Section 2.3.2), the usual course in schemes is for the application to the court at the first hearing to proceed ex parte and without the benefit of a contradictor. Normally, ASIC does not appear in court to make submissions at the first hearing. The court is not uncommonly faced with voluminous documents dealing with complex proposed arrangements and transactions. In these circumstances, the court has to rely largely on counsel for the applicant company to elicit the salient features of a scheme and explain its consequences for affected parties.

Given that ASIC already has a role in schemes (including under s 411(17)(b)), and in the absence of any other party to test propositions put to the court, the court should be able to request ASIC to appear at any stage of a particular scheme application, to assist the court on relevant matters. The Committee is pleased to note that ASIC has now indicated that it will respond to such requests.[338] The Committee believes that this is an important step in

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338 ASIC Regulatory Guide 60 (December 2009) at RG 60.114 states that ASIC will not normally appear before the court except in various circumstances, including where 'we [ASIC] have been asked to assist the court or provide the court with our views—this may occur even if we have no specific issues of our own to raise and do not oppose the scheme'.

assisting the court in fulfilling its role in reviewing proposed schemes, including in determining whether affected parties will be properly protected if the scheme is pursued.

6.4.3 Summary of recommendations for change

The Committee recommends that s 411(17) be recast so that:

- s 411(17)(a) is repealed
- ASIC retains the right to provide the court with an objection or no objection statement
- the court retains the ultimate power to approve or reject a scheme, with or without an objection or no objection statement from ASIC, taking into account the indication by ASIC that it will assist the court when requested.

7 Coverage of schemes

This chapter considers whether the provisions for members' schemes of arrangement should accommodate holders of options over unissued shares or convertible notes, be extended to cover managed investment schemes and be simplified for mergers within a wholly-owned corporate group.

7.1 Option and convertible noteholders

Companies sometimes issue options to subscribe for their shares. An example could be the issue of options to employees as part of their remuneration arrangements. Likewise, companies sometimes issue debt securities that are convertible into shares in specified circumstances. Questions arise about how these options or debt securities should be treated in a scheme.

The predominant view is that holders of options to subscribe for shares (optionholders) are contingent creditors of the company for the purpose of the scheme provisions.[339] Also, holders of corporate debt convertible into equity (noteholders) are creditors.[340]

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339 The relevant case law in support of the proposition that optionholders over unissued shares are creditors, including *Re MIA Group Ltd* (2004) 50 ACSR 29 at [3]-[9], *Solution 6 Holdings Limited* [2004] FCA 1049 at [14], *Re Australian Energy Ltd* [2006] FCA 155 and *Re Citect Corporation Ltd* (2006) 56 ACSR 663 at [1], as well as a contrary position taken in *Re Niagara Mining Ltd* (2002) 47 ACSR 364 (that these optionholders are contingent members), is analysed in HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.020] under the heading *Optionholders* and in *Australian Corporation Law: Principles and Practice* (LexisNexis Butterworths, looseleaf) at [5.1.0035]. See also *Sino Gold Mining Limited, in the matter of Sino Gold Mining Limited* [2009] FCA 1277 at [4]: 'The holders of the options are treated as "creditors" in the proposal in accordance with the prevalent view (the authorities were reviewed by Barrett J in *Re MIA Group Ltd* (2004) 50 ACSR 29 at [3]-[9]) – a view from which I will not depart.'
An optionholder who has exercised the option to take up shares prior to a meeting of shareholders, but whose name has not yet been entered on the register of members, may be a member for the purposes of the scheme provisions: *Re Etrade Australia Ltd* (1999) 31 ACSR 31.

340 See, for instance, *Re Crown Diamonds Nl* [2005] WASC 93 at [28].

In consequence, a corporate restructuring or other scheme to bind shareholders and optionholders or noteholders must proceed as a combined member/creditor scheme or as a series of interdependent schemes.[341] Optionholders and noteholders, as creditors, are subject to the headcount test, as well as the value test, in approving a scheme.[342]

This raises a number of questions, including:

- whether optionholders and noteholders should be given some right to participate in members' schemes
- if members' schemes are so expanded:
  - whether optionholders or noteholders should be treated as separate classes from holders of issued shares
  - whether the valuation of options or convertible notes needs to be clarified for the purpose of the value test.[343]

7.2 Managed investment schemes

7.2.1 Listed managed schemes

Listed managed investment schemes (listed managed schemes) form a significant portion of the market for securities. Listed property trusts represent about 10% of the ASX index. The growth in the number and market capitalisation of listed managed schemes has been driven in part by the growth of superannuation funds, as well as by innovations in their structure, including the use of 'stapled' schemes.[344]

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341 For instance, *Application of Australian Co-operative Foods Ltd* (2001) 38 ACSR 71, *Sino Gold Mining Limited, in the matter of Sino Gold Mining Limited* [2009] FCA 1277. See ASIC Regulatory Guide 60 at RG 60.61-RG 60.65 regarding specific disclosure requirements for schemes involving option holders or convertible note holders.

342 s 411(4)(a)(i).

343 Damian & Rich, supra footnote 5, at [3.4.3] point to some of the practical problems in valuing options and convertible notes.

344 See, for instance, *Macquarie Private Capital A Ltd* [2008] NSWSC 323.

The scheme provisions cannot be utilised by listed managed schemes.[345] A consequence is that the restructuring of listed managed schemes (or structures involving a combination of companies and listed managed schemes) can be more difficult and involve a combination of trust and corporate law. By way of contrast, the takeover bid provisions (as amended in March 2000) cover the acquisition of interests in listed managed schemes, as well as companies.[346]

Changes of control or other reorganizations of listed managed schemes have tended to proceed through 'trust schemes' under which unitholders pass a special resolution to amend the constitution of the managed scheme so that:

- all units, other than those held by the intending controller, are cancelled for a cash and/or other consideration (redemption scheme) or
- all units are transferred to the intending controller for a cash and/or other consideration (transfer scheme).[347] Transfer schemes for listed managed schemes also require a resolution of unitholders to permit the intending controller to acquire more than 20% of the units.[348]

There is no equivalent in 'trust schemes' of the judicial and other procedural protections applicable to schemes of arrangement, though

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345 The scheme provisions only apply to any 'Part 5.1 body', defined under s 9 as a company and a registrable body under Part 5B.2 of the Act.

346 s 604.

347 The court can deal with interrelated matters affecting a reorganization of a commercial structure involving changes to one or more trusts (through a trust scheme) and one or more related companies (through a Part 5.1 scheme). See, for instance, *Re Mirvac Ltd* (1999) 32 ACSR 107, where the Court approved a single explanatory document for shareholders of a company and unitholders of relevant trusts, to be supplemented by other documents tailored for the proposed changes to the company (pursuant to the scheme) and for proposed changes to the trusts.

348 Item 7 of s 611.

the proponents of a 'trust scheme' may choose to seek judicial direction or advice on its implementation.[349]

In the absence of a supervisory role for ASIC or the court in relation to a 'trust scheme', equivalent to their role in relation to a scheme, the Takeovers Panel has issued a Guidance Note that recommends various disclosure and voting procedures to be followed, and other matters to be complied with, under schemes for listed trusts:

> to avoid the risk that a Trust Scheme will lead to unacceptable circumstances for the purposes of section 657A of the Act, by denying unitholders reasonable and equal opportunities to share in the benefits of the scheme or sufficient information to assess the merits of the scheme, or by inhibiting an efficient, competitive and informed market in interests in the target trust.[350]

Extension of the scheme provisions to listed managed schemes may facilitate the rationalisation and redesign of complex corporate/trust structures through one process. It may also better protect the interests of unitholders or other beneficiaries, including through ASIC involvement and court review of a proposed scheme. The

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349 See, for instance, *Re Westfield Holdings Ltd* (2004) 49 ACSR 734 at [3], *Re Abacus Funds Management Ltd* [2005] NSWSC 1309, *Macquarie Private Capital A Ltd* [2008] NSWSC 323 at [3], *Re Macquarie Capital Alliance Ltd* [2008] NSWSC 745 at [19], *Re Macquarie Communications Infrastructure Group* [2009] NSWSC 487 at [16].

350 Takeovers Panel Guidance Note 15, *Listed trust and managed investment scheme mergers*, Overview. In *Re Colonial First State Property Trust Group (No 1)* (2002) 43 ACSR 143, the reorganization of various managed investment schemes was to be achieved through changes to their constitutions under s 601GC, requiring a special resolution of the members of each of the schemes. It would not have been possible to utilise the s 411 scheme provisions. The Takeovers Panel raised the question whether unitholders in managed investment schemes should be afforded greater protection under the Corporations Act in the context of reorganizations, pointing out that investor protection under a trust scheme is lower in various respects than under s 411, including that there is no court scrutiny of trust scheme proposals and that there are some differences in effective voting exclusions between the s 601GC and s 411 reorganization implementation routes. Takeovers Panel Guidance Note 15 was developed in consequence of this case.

Advisory Committee supported a similar approach in its earlier review of managed schemes.[351]

If listed managed schemes are to be included in the scheme provisions, the question arises whether it would be beneficial to override by statute any provision in the constituent documents of a managed scheme that would permit the same outcome as a Part 5.1 scheme, but by a different procedure.

7.2.2 Unlisted managed schemes

There is a question whether any extension of the scheme provisions should be limited to listed managed schemes.

The takeover bid provisions only apply to listed managed schemes.[352] This reflects the focus of the bid provisions on larger entities.[353] However, there appears to be no clear rationale for limiting any extension of the facilitative scheme provisions to listed managed schemes.

7.3 Mergers within corporate groups

The complex structure of some corporate groups may reflect a history of past corporate acquisitions, including the acquisition of companies that themselves are parent companies of other companies. The resulting structure may not necessarily meet the current commercial, managerial and accounting needs of a group.

Corporate groups may seek to simplify their structure through internal mergers that involve transferring the undertaking, assets or liabilities of one or more group companies to another group company (merger by absorption) or to a new group company. This

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351 The Australian Law Reform Commission/Advisory Committee report *Collective Investments: Other People's Money* (1993) vol 1, at 11.14, recommended that the merger provisions for managed investment schemes be based on Part 5.1 of the Corporations Act. The relevant model provisions in that report were based on the scheme provisions: vol 2 at 171–175. Recommendations to the same effect were also made in the Companies and Securities Law Review Committee Report *Prescribed Interests* (1988) at [133].

352 s 604.

353 Subsection 606(1) identifies the companies that are subject to the bid provisions. They cover only listed companies and unlisted companies with more than 50 members.

form of group reconstruction may affect the interests of creditors of each merging company (subject to cross-guarantee arrangements). However, for mergers within wholly-owned corporate groups, shareholders of subsidiaries do not need equivalent protection, given that all the shares of the subsidiaries are ultimately owned by the parent company.

One possibility, based on a recommendation in the Advisory Committee report *Corporate Groups*,[354] is to provide for the use within a wholly-owned corporate group of a short-form merger procedure that would dispense with shareholder involvement and reduce the role of the court. Under such a procedure:

- the directors of each affected group company would approve the merger, signing a certificate that they are satisfied that the merger will not materially affect the company's ability to pay its creditors[355]
- notice of the proposed merger would be given to all creditors of each affected group company, indicating the effect of the merger on creditors and stating that a creditor may apply to the court for relief within the prescribed period before the merger can become effective
- the court's supervision would be confined to hearing any creditor applications. A court would have the power, on application, to make any order it thinks fit, including to make provision for the applicant creditor or to modify or negate the proposed merger.

The holding company of the group could then apply to the court under s 413 to make any necessary orders to implement the proposed arrangement.

7.4 Schemes not supported by the company

As previously indicated (Section 2.3), in theory, it is open to any shareholder, as well as the company itself, to propose a scheme to

354 *Corporate Groups* (2000) paras 5.13-5.27 and rec 15.
355 Compare s 256B(1)(b). Directors could also be personally liable in the event that the company becomes insolvent through the merger: compare s 256E, Note 1.

change control of that company or for any other purpose.[356] However, the legislation proceeds on the basis that the company in question will take responsibility for proposing the scheme, including conduct of the scheme meeting.[357] In practice, scheme proposals are put to the court, and to the shareholders, by the company. Directors may determine that the company will initiate a scheme either because they support it or, for other reasons, they decide that shareholders should have the opportunity to consider it.[358]

For the sake of completeness, the Committee asked in the discussion paper whether the scheme provisions could or should be adapted to facilitate their use where the board of a company opposes a scheme promoted by a third party and is unwilling to put the proposal to shareholders and, if so, what procedural changes might promote this outcome. This raises a series of issues, including whether the directors of a target company should be required to co-operate with the proponent of a scheme that they oppose and, if so, in what manner.

7.5 Submissions

7.5.1 Option and convertible noteholders

The discussion paper raised the question whether optionholders and noteholders should be given a right to participate in members' schemes.

There was a variety of approaches by respondents on the treatment of option and convertible noteholders in a scheme, including:

- treat them as shareholders, rather than as creditors, as they have a deferred right to become shareholders[359]
- acknowledge that optionholders (but not necessarily noteholders, as they are widely accepted to be creditors) can be bound by a members' scheme of arrangement and give the court power to

356 s 411(1).

357 Subsection 412(1) states that, where a meeting is convened under s 411, 'the body' [meaning the scheme company] must send certain information to shareholders.

358 For instance, where an intending controller will offer a considerable premium to shareholders, but only by way of a scheme.

359 Australian Shareholders' Association.

fix a nominal voting entitlement for optionholders where there is a lack of certainty about the value of their 'debt and claims'[360]

- allow them to participate in members' schemes as separate classes from holders of issued shares (with different exercise prices and expiry dates being ignored)[361]

- widen the scheme mechanism to cover all types of interest in securities (including options and convertible notes), thereby allowing a scheme to be entered into between an entity and any class of security holder.[362]

Another view[363] was that holders of options or other convertible securities should not be entitled to participate in members' schemes, as they are not members unless and until they become so under the terms of issue of the security.

7.5.2 Managed investment schemes and other entities

Submissions were invited on whether the members' scheme of arrangement provisions should be extended to managed investment schemes (MISs) and other business entities such as unit trusts that are stapled to companies.

A number of submissions[364] supported extension of the scheme provisions to listed and unlisted MISs. Arguments in support of that approach included that:

- it would provide court and ASIC protection for unit holders

- it would provide a simpler and more transparent process for all parties

- it would provide greater certainty

360 Law Council of Australia.
361 Law Society of NSW.
362 Minter Ellison. See also Damian & Rich, supra footnote 5, at [3.4.5].
363 Allens Arthur Robinson.
364 Allens Arthur Robinson, Australian Shareholders' Association, ASIC, Law Council of Australia, Minter Ellison, RiskMetrics. See also Damian & Rich, supra footnote 5, at [3.5].

- a material proportion of the market for securities comprises managed investment schemes (or stapled groups that include a managed investment scheme)
- extending the scheme provisions to MISs would do away with the need for separate compliance with the prospectus provisions, which currently apply to reconstructions that are effected through informal trust schemes, such as those involving a stapled group consisting of one or more companies and trusts
- it would assist acquirers to obtain exemptions from the requirement to issue formal disclosure documents in some foreign jurisdictions which require a court-sanctioned scheme as a prerequisite for relief.

Other submissions[365] supported extension of the scheme provisions to listed MISs and unlisted MISs with 50 members or more.

Two submissions[366] argued that, if the scheme provisions were applied to MISs, any provisions in the constituent documents of an MIS that purport to exclude the operation of the scheme provisions should be overridden.

7.5.3 Mergers within corporate groups

Submissions were invited on whether the legislation should be amended to include a short-form procedure for mergers within wholly-owned corporate groups that would dispense with shareholder involvement and reduce the role of the court to consideration of any creditor applications.

Submissions generally supported a short-form merger process for intragroup restructuring, proposed by the Advisory Committee in its *Corporate Groups* report (see Section 7.3, above), arguing that it would save time and cost without disadvantaging affected parties.[367]

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365 AICD, Law Society of NSW.
366 Law Council of Australia, Law Society of NSW.
367 Australian Shareholders' Association, Law Council of Australia, Law Society of NSW, Minter Ellison.

7.5.4 Schemes not supported by the company

The discussion paper raised the question whether the scheme provisions could, or should, be adapted to facilitate their use where a board opposes a scheme proposed for the company by a third party and, if so, what procedural changes would be necessary.

Respondents who addressed this question[368] were opposed to adaptation of the scheme provisions to facilitate schemes which were not supported by the subject company, for reasons including that:

- a hostile scheme is inconsistent with the character of a scheme as emanating from the entity and requiring the support and participation of the scheme company’s board
- the alterations required would be significant and unnecessary, given that the Chapter 6 bid provisions already afford an appropriate mechanism for hostile bids
- it is not possible or appropriate for a single explanatory statement to be prepared for a scheme that is not supported by the board of the company in question.

7.6 Advisory Committee position

7.6.1 Option and convertible noteholders

The Committee does not see a need for a legislative change in relation to the position of noteholders and optionholders in a scheme. The prevailing view is that noteholders and optionholders (until such time as they exercise their conversion rights) are creditors. As such, they have no right to participate in members’ schemes and are not bound by these schemes. Their interests can be protected by the discretion of the court to reject a members’ scheme that is, in some way, unfair to optionholders or noteholders.

In some cases, a person seeking control of a company may wish to acquire all its voting securities, including options or notes that are convertible into equity. This can be achieved through interdependent members’ and creditors’ schemes. In these circumstances,

368 AICD, Law Council of Australia, Law Society of NSW, Minter Ellison, Abacus – Australian Mutuals, RiskMetrics.

optionholders and noteholders would be entitled to vote on the creditors' scheme.

7.6.2 Managed investment schemes and other entities

The Committee supports the extension of the scheme provisions to listed and unlisted managed investment schemes (MISs). These entities (or stapled groups that include an MIS) make up a significant proportion of the market for securities. An extension of the scheme provisions to MISs and stapled structures would provide a simpler and more transparent process for all parties, compared with the current procedures which require compliance with a combination of trust and corporate law. It would also provide greater certainty of outcome, particularly in the case of stapled structures, if the scheme meetings of the company and the MIS were run simultaneously. The supervisory role of ASIC and the court would help protect unitholders.

It is noted that such an extension would require resolution of a number of procedural issues that are not addressed in this report.

7.6.3 Mergers within corporate groups

The Committee continues to see real benefits in introducing a short-form merger procedure for wholly-owned corporate groups, as proposed in its *Corporate Groups* report (see Section 7.3, above). Such an approach would simplify and expedite the rationalisation or other reconstruction and the consequential governance of corporate groups.

7.6.4 Schemes not supported by the company

The Committee considers that it is impractical and unnecessary to adapt the scheme provisions for use by a third party without the co-operation of the subject company. Those provisions are not designed for that purpose. A party seeking control of a company without the support of that company's board can proceed through a Chapter 6 bid.

7.6.5 Summary of recommendations for change

The Committee recommends that:

- the scheme provisions be extended to cover listed and unlisted managed investment schemes
- a short-form merger procedure be introduced for companies within wholly-owned corporate groups.

8 Other matters

This chapter considers a number of other issues concerning schemes arising out of the analysis in the discussion paper and submissions received. It also touches on a separate procedure for restructuring companies and considers the role of creditors' schemes.

8.1 ASIC registration requirements

The explanatory statement for a proposed scheme must be registered with ASIC before it can be circulated to shareholders.[369]

One submission[370] raised questions concerning this registration requirement, arguing that:

- it serves no purpose in practice
- the court cannot convene a scheme meeting unless it is satisfied that ASIC has had a reasonable opportunity to consider the explanatory statement for the scheme and make submissions on it (s 411(2)(b))
- as a practical matter, ASIC seems to accept an explanatory statement for registration (see s 412(8)) if the court has made an order convening a meeting under s 411(1) or s 411(1A)
- its only real effect is to catch the unwary.

The respondent favoured replacement of the obligation to register the document with a requirement for lodgment of the document with ASIC.

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369 s 412(6). Subsection 1274(8) sets out the criteria for ASIC to consider in determining whether to register a document. See also ASIC Regulatory Guide 60 at RG 60.11-RG 60.13.

370 Minter Ellison. See also Damian & Rich, supra footnote 5, at [5.12.2].

8.2 Alteration of the constitution

A scheme that involves an amendment to the constitution of a company requires that shareholders separately approve the amendment,[371] as well as the scheme itself.

The discussion paper raised the question whether the court's power to approve a scheme should include a power to order that the company's constitution be altered, without the shareholders having to approve the alteration through a separate procedure.

It was pointed out in submissions supporting such a power that the approval requirement to change a constitution, namely a special resolution,[372] is either the same as the voted shares test under a scheme[373] or possibly less onerous if the proponents of the change form a separate class for the purpose of voting on the scheme.

8.3 Voting on a capital reduction as part of a scheme

A scheme that involves a reduction of capital requires that shareholders separately approve the reduction, as well as the scheme itself (see Section 3.6.1).

The discussion paper raised the question whether a return of capital associated with a scheme should be able to be approved at the scheme meeting without the need for additional and separate approval pursuant to the reduction of capital provisions.

One view in submissions was that, where a scheme also involves a reduction of capital, it is preferable for shareholders to vote only once, at one meeting, and pursuant to the voting requirements for approval of a scheme.[374]

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371 Subsections 136(2)-(4) provide that a company may amend its constitution by special resolution, subject to any further requirement specified in the constitution. ASIC Regulatory Guide 60 at RG 60.41 points out that a scheme cannot be used to avoid a specific procedure laid down by the Corporations Act, although it can often be combined with that procedure.

372 See s 136(2), definition of 'special resolution' in s 9. A company's constitution may provide for additional requirements: s 136(3), (4).

373 See Section 2.3.1 for an outline of the voted shares test.

374 Minter Ellison.

It was also pointed out that, under the first of the two special resolution voting requirements for a selective capital reduction, only the intending controller and shareholders who oppose the reduction may be eligible to vote. Approval of the selective reduction may be very difficult to achieve where there is some level of active dissent and the person seeking corporate control has only a minimal shareholding.[375]

Some respondents[376] said that this problem might be overcome if it was made clear that consideration received under a cancellation scheme that, in effect, is being funded by an intending controller, is not received 'as part of the reduction' under s 256C(2)(a), as it does not reduce the company's capital to the potential detriment of creditors. In consequence, shareholders supporting the capital reduction would be entitled to vote on both of the special resolutions needed for approval of a cancellation scheme.

8.4 Third party encumbrances

8.4.1 Current position

Shares that are intended to be extinguished or transferred under the terms of a scheme may already be subject to a security or other third party encumbrance. The rights of a third party with a lien, charge or other encumbrance over a share cannot be extinguished under a 'no encumbrances' provision in scheme documents where the person who is to receive the shares has notice of that interest. An acquirer may have to rely on the doctrine of bona fide purchase without notice to avoid receiving the shares subject to any third party encumbrance over them:

> Apparently the purpose of a vesting free of encumbrances term [in a scheme] is only to make clear, as is the position under general law principles, that the acquiring company takes the shares free of equitable interests of which it was unaware. A third party would not suffer the extinguishment

375 Damian & Rich, supra footnote 5, at [3.2.4].
376 Allens Arthur Robinson, Law Council of Australia.

> of an interest in shares if [the acquiring company] had notice of that interest.[377]

The scheme documents may provide for warranties by shareholders (binding all shareholders including any dissidents) that they will transfer their shares free of all mortgages, charges, liens and encumbrances and interests of third parties. The purpose of these warranties is to ensure that a shareholder with encumbered shares is not unfairly advantaged. The amount of the damages payable for breach of the warranty would be equal to the amount required to discharge the encumbrance. However, these warranties do not, of themselves, extinguish the rights of a third party over the shares.[378]

8.4.2 Submission

One respondent[379] argued that the scheme provisions should be amended to provide that, subject to a court order, the acquisition of interests by a scheme proponent is free from third party encumbrances, even where the acquirer has actual or constructive notice of the encumbrance, provided there is no intention to diminish unfairly the value of third party rights. Rather, the encumbrance should attach to the scheme consideration in the hands of the shareholder who receives it. The holder of any encumbrance who considers this unreasonable could argue that the scheme not be approved at the second court hearing.

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377 *Re Investa Properties Ltd* [2007] FCA 1104 at [28]-[30]. See also *Re WebCentral Group Ltd (No. 2)* [2006] FCA 1203 and *Scarborough Equities Limited (No 2)* [2009] FCA 484 at [9]-[10].
See also the discussion in HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [14.07] under the heading *The acquisition of encumbered shares.*

378 *Re APN News & Media Ltd* [2007] FCA 770 at [57]-[62], *Re Hostworks Group Ltd* [2008] FCA 64 at [41], followed in *Re Macquarie Private Capital A Ltd* [2008] NSWSC 323 at [13]-[14] and *Re St George Bank Ltd* [2008] FCA 1839, *Re Scarborough Equities Limited (No 2)* [2009] FCA 484 at [9]-[10], *Sino Gold Mining Limited, in the matter of Sino Gold Mining Limited* [2009] FCA 1277 at [29]-[31], *eircom Holdings Limited, in the matter of eircom Holdings Limited* [2009] FCA 1418 at [29]-[30], *IOR Group Limited* [2009] FCA 1588 at [12]-[14]. For instance, in *Re Macquarie Communications Infrastructure Group* [2009] NSWSC 487, the scheme documents provided that the shareholders are taken to have warranted to various relevant parties that all their shares are transferred to the bidder on a fully paid basis and free from all mortgages, charges, liens, encumbrances and interests of third parties.

379 Minter Ellison. See also Damian & Rich, supra footnote 5, at [3.3.2].

8.5 Share acquisitions under s 414

Section 414 provides a procedure, separate from a scheme, involving an offer to acquire voting shares in a company, with provision for the compulsory acquisition of the shares of non-accepting shareholders, or those shareholders having buy-out rights, in certain circumstances.

Submissions were invited on whether s 414 still performs a useful function not performed by schemes, bids or other means to effect a change of control and, if so, on possible changes to facilitate or better regulate this offer process.

Two submissions[380] supported repeal of s 414, arguing that:

- it is rarely used
- it does not appear to perform a useful function
- it is poor policy, badly drafted and rendered redundant by recent legislative amendments.

Another submission[381] supported the retention of s 414.

8.6 Creditors' schemes

While the focus of this report is on members' schemes, it is noted for completeness that Part 5.1 of the Corporations Act also makes provision for creditors' schemes.

Creditors' schemes may be used by solvent companies for various purposes, including to extend a corporate reorganization to contingent creditors, such as holders of options over unissued shares or convertible noteholders, and to settle outstanding or future claims within the reinsurance industry.[382] A creditors' scheme can also be a

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380 Allens Arthur Robinson, Law Council of Australia.

381 Minter Ellison.

382 *Re Mercantile Mutual Insurance (Aust) Ltd* (2002) 43 ACSR 676 and *NRG London Reinsurance Co Ltd* (2006) 58 ACSR 674 are instances of creditors' schemes for solvent companies within the reinsurance industry. The purpose of these schemes is explained by N Mavrakis and P Mann in 'Solvent Schemes of Arrangement in the Australian Reinsurance Industry' *International Corporate Rescue* Vol 5, Issue 2 (2008) at 86–90.

useful way to assist a company in financial difficulties, for instance through an arrangement whereby the company's debt obligations to all or some classes of its creditors are deferred, reduced or otherwise adjusted.

A creditors' scheme may also be used as a means of injecting capital into a still solvent company that is subject to aggrieved shareholder claims of the type considered in *Sons of Gwalia Ltd v Margaretic* (2007).[383] A potential investor may only be willing to provide further funding to the company if it enters into a creditors' scheme of arrangement under which aggrieved shareholders agree to compromise or subordinate their claims against the company on terms that are satisfactory to the investor.

A creditors' scheme may also be used to settle creditor claims against third parties associated with a company (third party releases). In the Opes Prime matter, the Court approved an arrangement involving a binding settlement of all claims by creditors against companies in the Opes Prime Group and also against their financiers and various other third parties that had been involved in the operation of the Group.[384] By contrast, third party releases are void under deeds of company arrangement pursuant to a voluntary administration.[385]

The Advisory Committee, in a separate report, has also recommended a legislative amendment to enable a creditors' scheme to be utilised for a defined class of unascertained future personal injury claimants.[386]

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383 (2007) 232 ALR 232, 60 ACSR 292, 25 ACLC 1.

384 *In the matter of Opes Prime Stockbroking Limited* [2009] FCA 813 and *In the matter of Opes Prime Stockbroking Limited (No 2)* [2009] FCA 864. An appeal to the Full Federal Court was dismissed in *Fowler v Lindholm, in the matter of Opes Prime Stockbroking Limited* [2009] FCAFC 125.

385 *City of Swan v Lehman Brothers Australia Ltd (Subject to Deed of Company Arrangement)* [2009] FCAFC 130. See further A Hargovan, 'Limitations to deed of company arrangements: the Lehman Brothers case' *Insolvency Law Bulletin* October 2009 at 39-41; G Selikowitz, 'Opes Prime and Lehman Brothers – third-party releases in schemes of arrangement and deeds of company arrangement' *Insolvency Law Bulletin* October 2009 at 42-46.

386 *Long-tail liabilities: the treatment of unascertained future personal injury claims* (May 2008) Chapter 7.

In the case of insolvent companies, it is noted that creditors' schemes have been largely superseded by voluntary administrations conducted under Part 5.3A of the Corporations Act.[387]

Submissions were invited on whether creditors' schemes still perform a useful function.

The general view in submissions was that creditors' schemes are useful and should be retained.

8.7 Advisory Committee position

8.7.1 ASIC registration requirements

The Committee sees no reason to remove the regulatory requirement that the explanatory statement be registered. This requirement is not inconsistent with the role of ASIC in relation to schemes. In regard to the concern raised in the submission that the registration requirement may 'catch the unwary', it is noted that the court can waive minor irregularities in compliance with this procedural requirement.[388]

8.7.2 Alteration of constitution

Where an alteration to a company's constitution is an element of a scheme for which shareholder approval has been obtained, the Committee favours conferral on the court of a power to order that the constitution be altered, without requiring a separate shareholder vote on that matter. The approval requirement for a change to a

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387 *Re Pasminco Ltd* (2002) 41 ACSR 511 at [72] contains a useful summary of some of the principal differences between a creditors' scheme and a deed of company arrangement under the voluntary administration provisions in Part 5.3A.

388 In *Re Heartware Ltd* [2008] FCA 1997 at [16], Emmett J, in approving a scheme at the second court hearing, made the following observation:

> Section 412(6) of the Act required that the Company not send out an explanatory statement pursuant to s 412(1), unless a copy of the statement had been registered with the Australian Securities and Investment Commission (the Commission). As a result of a misunderstanding by the Company's solicitors, the explanatory memorandum was dispatched to members prior to its registration. That fact was drawn to the attention of the Commission, which appears to have raised no objection. In fact, the Commission had received a copy of the final form of the explanatory memorandum prior to its dispatch. Further, the Commission, by letter of 29 October 2008 addressed to the Company's solicitors, has indicated that it has no objection to the schemes of arrangement.

company's constitution, namely a special resolution, is either the same as the voted shares test under a scheme or possibly, in effect, less onerous if the proponents of the change form a separate class for the purpose of voting on the scheme.

8.7.3 Voting on a capital reduction as part of a scheme

The Committee has considered various policy options where a reduction of capital is part of a scheme, including:

- dispensing with the special voting requirements for reduction of capital in some or all circumstances, provided the level of disclosure under the scheme is no less than under the reduction of capital disclosure requirements. The court could take the views of dissidents into account in determining whether to approve the scheme at the second court hearing
- dispensing with the reduction of capital provisions where the court so approves
- giving ASIC modification or exemption powers in relation to the voting requirements for a capital reduction.

The Committee recognises that the interests of dissident shareholders could be diminished if the voting procedures under a reduction of capital are excluded altogether. A preferable approach would be to give the court a discretion to dispense with all or some of the reduction of capital approval provisions where it considers it appropriate for a particular scheme. In determining whether to exercise its dispensation power, the court would be able to take the interests and views of any dissenting shareholder into account.

8.7.4 Third party encumbrances

The Committee has considered whether the scheme provisions should be amended to provide that, subject to a court order, the acquisition of shares (or other securities) by a person under the terms of a scheme will be free from any third party encumbrance, which encumbrance would instead attach to the consideration for the acquired shares. The Committee notes a judicial observation that:

> It is not practicable for amounts secured by encumbrance to be deducted from the Scheme Consideration payable to the relevant Scheme participants on the implementation date.[389]

The Committee is not persuaded of the need for a legislative change. It does not consider that any problems that may arise in practice are such as to merit a change in the law to override the rights of third parties.

8.7.5 Share acquisitions under s 414

While the s 414 mechanism does not appear to have been utilised in recent times, the Advisory Committee is not aware that it has given rise to problems or been used to avoid protections that would otherwise be available to shareholders. There is no apparent reason for its amendment or repeal at this stage.

8.7.6 Creditors' schemes

While some forms of creditors' schemes may have become less common because of the alternative voluntary administration procedure for insolvent companies, they nevertheless perform a useful function in other circumstances and should be retained.

8.7.7 Summary of recommendations for change

The Committee recommends giving the court the power:

- to order that a company's constitution be altered to the extent necessary to implement a scheme, without shareholders having to approve the alteration through a separate procedure
- to dispense with all or some of the reduction of capital approval provisions where it considers it appropriate for a particular scheme.

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389 *Re APN News & Media Ltd* [2007] FCA 770 at [59].