



Australian Government

**Corporations and Markets
Advisory Committee**

MEMBERS' SCHEMES OF ARRANGEMENT

Discussion Paper

**June
2008**

Corporations and Markets **Advisory
Committee**

Members' schemes of
arrangement

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ISBN 978-0-9803190-9-5 (print version)

ISBN 978-0-9805232-0-1 (on-line version)

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Request for submissions

The Advisory Committee invites submissions on any aspect of the matters covered in this paper concerning members' schemes of arrangement, including the matters set out in:

- Section 3.5
- Section 4.3
- Section 5.3
- Section 6.5.

The Committee also invites submissions on other aspects of members' schemes that may call for consideration.

Submissions are also invited on the other matters referred to in Section 1.5.

Please email your submission, in Word format, to:

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If you have any queries, you can call (02) 9911 2950.

Please forward your submissions by **Friday 26 September 2008**.

All submissions, unless marked confidential, will be published at **www.camac.gov.au**

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1 Introduction

This chapter describes the purpose and scope of the review, describes schemes of arrangement, and outlines the issues raised in this paper.

1.1 Purpose of the review

Members' schemes of arrangement under Part 5.1 of the Corporations Act are a commonly used mechanism for achieving structural change within a company or a corporate group. They can be tailored to novel or complex corporate structures or be used for major group reconstructions.

Members' schemes are also increasingly used as a means of achieving changes of corporate control. The use of these schemes as an alternative to takeover bids under Chapter 6 of the Corporations Act has received judicial and regulatory recognition.

Given the increasing and changing use of members' schemes, and the fact that the relevant provisions of the Corporations Act have remained largely unchanged over many years, a general review of those provisions seems timely. The Advisory Committee received from the former Government a reference concerning the 'headcount' test for shareholder approval of members' schemes. 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.

1.2 Scope of the review

1.2.1 Reference concerning the headcount test

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.¹

The other matters in the May 2007 reference are dealt with in the Advisory Committee discussion paper *Issues in external administration* (February 2008).

1.2.2 Broader review

The Committee considers that, in addition to considering the headcount test, it is useful to consider other matters related to members' schemes that might benefit from public discussion.² While the Committee has previously considered schemes in various contexts,³ they have not been the subject of a general review. Also, a broader review of members' schemes seems appropriate in light of their relatively frequent use as an alternative to a takeover bid under Chapter 6 of the Corporations Act to achieve a change of corporate control, as well as their use for other forms of corporate reorganization.

This paper identifies a range of issues that have arisen in practice with members' schemes and that may benefit from further consideration. The aim is to consider the effectiveness and appropriateness of the current legislative and regulatory approach to the facilitation of corporate restructuring. The paper does not purport to be an exhaustive review and respondents are invited to raise other aspects of members' schemes that may benefit from further consideration.

1.2.3 Terminology

In this paper, for ease of reference:

- members' schemes are generally referred to as 'schemes'
- takeover bids are referred to as 'bids'

¹ Law Council of Australia Submission to Treasury on the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007.

² The Advisory Committee can initiate its own reviews, as well as respond to matters referred to it by the Government: *ASIC Act* s 148.

³ Schemes have been considered in the CAMAC reports *Compulsory Acquisitions* (1996) paras 5.1-5.14, *Corporate Groups* (2000) paras 5.1-5.60 and *Long-tail liabilities: the treatment of unascertained future personal injury claims* (May 2008) Chapter 7.

- 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).

1.3 Outline of the scheme provisions

1.3.1 Legislative history

The procedures requiring shareholder and court approval of schemes of arrangement have not substantially changed since their introduction.

Australian legislation in this area 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.⁴

The scheme provisions were adopted into Australian State-based law,⁵ and were included in the 1961 State Uniform Companies Acts.⁶ They were included, without substantive change, in the 1981 national companies and securities legislation.⁷ An amendment in 1982 introduced the current form of what may be referred to as the takeover avoidance provision⁸ (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

⁴ 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.

⁵ *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.

⁶ Uniform Companies Acts (1961–1962) ss 181–185.

⁷ *Companies Act 1981* ss 314–319.

⁸ *Companies Act 1981* ss 315(21), also found in s 317(5).

the Corporations Law,⁹ which applied from 1991. Those provisions were carried over into the current Corporations Act in 2001.¹⁰

It is noted for completeness that, 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.¹¹

1.3.2 Scope

The scheme provisions under 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.¹²

A scheme can cover any 'compromise or arrangement' between a company and its shareholders. A compromise involves a settlement of a dispute.¹³ An arrangement is not so limited and can cover any lawful arrangement that touches or concerns the rights and obligations of the company and its shareholders,¹⁴ including:

⁹ *Corporations Law* ss 410–415A.

¹⁰ *Corporations Act* 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.

¹¹ *Companies Act 2006* (UK) ss 895–901 (schemes generally), ss 902–918 (additional provisions for mergers).

¹² *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.

¹³ *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.

¹⁴ *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'.

- corporate reconstruction or reorganization, which may involve an amalgamation or merger of companies¹⁵
- de-mutualisations¹⁶
- the de-merger or break-up of a company or a corporate group¹⁷
- changes of control that are functionally equivalent, and therefore an alternative, to a takeover bid.

¹⁵ Mergers 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. 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'.

Companies may effect a merger essentially in either of two 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 NI* [2005] WASC 93 at [10], *pSivida Limited v New pSivida, Inc* [2008] FCA 627. 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:

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 whole or part of the undertaking, property or liabilities of the transferor company to ensure that the merger is fully and effectively carried out.

¹⁶ For instance, *Re MBF Australia Ltd* [2008] FCA 428.

¹⁷ 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).

1.3.3 Procedural steps

The key procedural steps in a scheme¹⁸ are:

- preparation of a draft notice convening the meeting of shareholders and an explanatory statement to implement the scheme, with notification to ASIC¹⁹
- application to the court to convene a meeting or meetings (if more than one class) of shareholders (the first court hearing).²⁰ 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, that the scheme is properly proposed, and that ASIC has been given a reasonable opportunity to examine the proposed scheme documentation and has not raised any objections at this stage.²¹ In this way, the court has the opportunity to filter out poorly disclosed, unworkable, or grossly

¹⁸ A useful overall summary is set out by Emmett J in *Central Pacific Minerals NL* [2002] FCA 239 at [2]-[14].

¹⁹ Section 412 and Corp Regs Schedule 8 Part 3 set out the information to be included in the explanatory statement.

²⁰ s 411(1).

²¹ s 411(2), (3). *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 Central Pacific Minerals NL* [2002] FCA 239 at [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].

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.

unfair schemes.²² The court may also in appropriate cases revoke an earlier order to convene a scheme meeting²³

- voting by shareholders at the properly convened meeting or meetings.²⁴ 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,²⁵ regardless of the shareholding of each participating shareholder. The voted shares test is a special majority (75%) of the 'votes cast on the resolution', for a body with a share capital.²⁶ For the usual situation of a company with one vote per share, this test means 75% of the shares voting on the resolution²⁷
- if approved by shareholders, application to the court to approve the scheme (the second court hearing). It is also at this hearing that ASIC may provide a letter pursuant to s 411(17)(b). The court has a general discretion whether to approve a scheme, over and above being satisfied that the voting and other procedural

²² 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'.

²³ *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.

²⁴ 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].

²⁵ 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.

²⁶ 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)). The headcount test applies to both members' and creditors' schemes.

²⁷ 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.

requirements have been complied with.²⁸ 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,²⁹ approve it with such alterations or conditions as it thinks fit,³⁰ or withhold approval until all conditions precedent to the implementation of the scheme have been fulfilled.³¹ The court may also have to consider issues concerning foreign-resident shareholders.³² However, the court does not have the power to be selective as to the shareholders who will be bound by the scheme³³

- lodgement with ASIC of the court order approving a scheme³⁴ and annexing that order to the company's constitution.³⁵

²⁸ 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 have agreed to the scheme: *Re NRMA Ltd* (2000) 33 ACSR 595 at [37].

²⁹ s 411(4)(b).

³⁰ s 411(6).

³¹ *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.

³² See *Re Central Pacific Minerals NL* [2002] FCA 239 at [28]-[31], *Re Simeon Wines Ltd* (2002) 42 ACSR 454 at [21]-[26], *Re Permanent Trustee Co Ltd* (2002) 43 ACSR 601 at [14].

³³ 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'.

³⁴ 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 any court-imposed condition.

³⁵ s 411(11). The purpose of the annexation requirement is explained in *Re Equinox Resources Ltd* (2004) 49 ACSR 692 at [22].

The court may exercise its power under s 411(12) to dispense with this annexation requirement where the scheme would not 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.

An approved scheme binds all shareholders (or the relevant class), including those who voted against the scheme or did not vote. A scheme may, depending on its terms, involve the compulsory acquisition of shares in the company, including those held by dissident or apathetic shareholders.

1.4 Matters dealt with in the paper

Chapter 2 considers a range of factors that may influence the choice between schemes, bids and reductions of capital to effect a change of control. This discussion also sets the context for the consideration in subsequent chapters of various issues and policy options regarding the regulation of schemes.

Chapter 3 discusses a range of issues concerning the information to be provided to shareholders to assist them in deciding whether to approve a scheme.

Chapter 4 considers possible procedural changes relating to voting by different classes of shareholders and whether the headcount voting requirement should remain.

Chapter 5 considers whether ASIC should have additional modification powers and whether the takeover avoidance provision (s 411(17)), which prohibits the court from approving a scheme in certain circumstances, should be repealed or amended.

Chapter 6 discusses whether the scheme provisions should extend 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 and be adapted for schemes opposed by the target company.

In preparing this paper, 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* (2004)³⁶ (hereinafter referred to as Damian & Rich). Those authors focus on the development of schemes as an

³⁶ T Damian and A Rich, *Schemes, Takeovers and Himalayan Peaks* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, University of Sydney) Monograph 1 (2004).

alternative to bids for achieving changes of control, and put forward various proposals for changes to the scheme provisions. Their comments are noted at various places in this paper.

1.5 Other matters

1.5.1 Creditors' schemes

Creditors' schemes of arrangement have been 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 note holders, and to settle outstanding or future claims within the reinsurance industry.³⁷

Creditors' schemes may also become one method to inject 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).³⁸ A potential investor may be willing to provide further funding to the company only if it enters into a creditors' scheme of arrangement under which the aggrieved shareholders agree to compromise or subordinate their claims against the company on terms that are satisfactory to the incoming investor.

The Advisory Committee has also recommended permitting creditors' schemes for a defined class of unascertained future personal injury claimants.³⁹

In the case of insolvent companies, creditors' schemes appear to have been largely superseded by voluntary administrations conducted under Part 5.3A of the Corporations Act.⁴⁰

This paper deals primarily with schemes for shareholders. The only discussion of creditors is in the context of schemes involving holders

³⁷ *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.

³⁸ (2007) 232 ALR 232, 60 ACSR 292, 25 ACLC 1.

³⁹ CAMAC report, *Long-tail liabilities: the treatment of unascertained future personal injury claims* (May 2008) Chapter 7.

⁴⁰ *Re Pasmenco 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.

of options over unissued shares and holders of convertible notes (Section 6.1).

However, submissions are invited on the general question of the extent to which creditors' schemes for solvent or insolvent companies still perform a useful function, and on possible changes to facilitate or better regulate these schemes.

1.5.2 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 are 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.

1.6 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 at the time of settlement of this discussion paper 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

- Barbara Bradshaw—Chief Executive Officer, Law Society Northern Territory, Darwin
- Jeremy Cooper—Deputy Chairman, Australian Securities and Investments Commission
- Alice McCleary—Company Director, Adelaide
- Marian Micalizzi—Chartered Accountant, Brisbane
- 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 at the time of settlement of this discussion paper are:

- Nerolie Withnall (Convenor)—Company Director, Brisbane
- Lyn Bennett—Partner, Minter Ellison, Darwin
- Elizabeth Boros—Professor of Law, Monash University, 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
- Laurie Shervington—Partner, Minter Ellison, Perth

- Gabrielle Upton—Legal Counsel, Australian Institute of Company Directors, Sydney.

The Executive comprises:

- John Kluver—Executive Director
- Vincent Jewell—Deputy Director
- Anne Durie—Legal Officer
- Thamani Parrino—Office Manager.

2 Change of control

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

2.1 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.⁴¹

Schemes have been increasingly used to achieve changes of control, notwithstanding moves over the last decade to overcome difficulties in achieving complete control through a bid.⁴² According to ASIC, since the beginning of last year almost as many schemes have been employed for this purpose with listed entities as have takeover bids. A similar trend towards increasing use of schemes has developed in the United Kingdom.⁴³

⁴¹ *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.

⁴² 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.

⁴³ 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).⁴⁴ Also, a form of buy-back arrangement may be an element of a scheme.⁴⁵ 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.

2.2 Change of control through schemes

The use of schemes to achieve a change of control has been recognised in case law,⁴⁶ government commentary⁴⁷ and regulatory practices.⁴⁸

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:

- *cancellation schemes*: whereby shares, other than those held by the intending controller, are cancelled pursuant to a capital

⁴⁴ Buy-backs are regulated under ss 257A–257J.

⁴⁵ *Re Village Roadshow Ltd* (2003) 48 ACSR 167.

⁴⁶ 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.

⁴⁷ 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.

⁴⁸ ASIC Regulatory Guide 60. 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.

reduction, with shareholders being paid out, and/or being allotted shares in another company.⁴⁹ A scheme that has a capital reduction as one of its elements must also comply with the capital reduction provisions (see Section 2.6)⁵⁰

- *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).⁵¹

In practice, transfer schemes are now more common than cancellation schemes. If the intending controller is a company, the effect of the scheme is to make the company whose shares are cancelled or transferred its wholly-owned subsidiary.

2.3 Choosing between a scheme and a bid

2.3.1 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.

⁴⁹ 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.

⁵⁰ *Re Cooper, Cooper v Johnson Ltd* [1902] WN 199. See also *Re Advance Bank Australia Ltd* (1997) 22 ACSR 513.

⁵¹ 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* [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. See further HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.071]

The acquisition of encumbered shares.

For instance, bids are subject to detailed initial and ongoing legislative disclosure requirements.⁵² Schemes are subject to somewhat less prescriptive disclosure obligations,⁵³ 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.⁵⁴

ASIC takes a similar position in regard to comparable levels of disclosure.⁵⁵

Directors of target boards have comparable disclosure obligations for bids and schemes, though the scheme disclosure provisions are in some respects more prescriptive than the bid provisions.⁵⁶ Also, issues related to duties of directors of target companies, including how to respond to rival change of control proposals, and possible

⁵² Part 6.5 Divisions 2–4.

⁵³ ss 411(3), 412, Corp Reg 5.1.01 and Corp Regs Schedule 8 Part 3.

⁵⁴ *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)* (International Bar Association/Law Council of Australia Conference, April 2008), 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.

⁵⁵ ASIC Regulatory Guide 60 at [RG 60.8] ff and [RG 60.20].

⁵⁶ Disclosure obligations for directors of the company the subject of the proposed scheme are set out in the 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. For bids, general, as well as some specific, disclosure obligations are set out in s 638.

conflicts of interest within target boards and management, can arise in any form of change of control transaction.⁵⁷

Differences

In theory, any shareholder, as well as the company itself, can propose a scheme to effect a change of control.⁵⁸ However, in practice, scheme proposals invariably are put to the court, and to the shareholders, by the company.⁵⁹ Directors may agree to initiate a scheme because they either support the proposed change of control or, for other reasons, consider that shareholders should have the opportunity to consider it.⁶⁰ Proposals for a change of control that are opposed by the company invariably proceed by way of a hostile bid, not a scheme. The close involvement of the directors of the company in the scheme process highlights the fiduciary duties (including under ss 180–183) they owe in this situation. These duties may be particularly significant, given that schemes may reduce, though not necessarily eliminate, the likelihood of an auction for control developing.⁶¹

⁵⁷ 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*.

⁵⁸ s 411(1).

⁵⁹ As pointed out by Justice KE Lindgren of the Federal Court, in his paper *Private Equity and Section 411 of the Corporations Act 2001 (Cth)* (International Bar Association/Law Council of Australia Conference, April 2008):

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:

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*.

⁶⁰ 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.

⁶¹ 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.

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.⁶² 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 benefits, and consequences, of seeking a change of control through a scheme or a bid.

2.3.2 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.⁶³

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

- ***dealing with more complex structures.*** Some change of control arrangements, though comparable in overall effect to a bid, contain additional elements that require that they be dealt with together through a scheme, by itself or in combination with

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'.

⁶² Part 6.5 Divisions 3 and 4—*The Target's response*.

⁶³ 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].

some other statutory procedure.⁶⁴ A scheme can also be part of a wider arrangement that includes third parties⁶⁵

- ***absence of some restrictions.*** The rules governing bids impose various constraints on the terms of the bid, including in regard to the types of conditions and collateral benefits. There are no equivalent specific restrictions under the scheme provisions, though the court could take comparable matters into account in determining whether to approve a scheme. These matters are further discussed below (Section 2.4)
- ***certainty within a predictable time frame.*** A scheme will either be approved or be rejected outright by shareholders at one or more scheme meetings (though the court may order that the headcount requirement be disregarded). This provides financiers and other interested parties with some certainty concerning timing and outcome of the proposal, subject to approval by the court.⁶⁶

In comparison, there can be a much 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.⁶⁷ A bidder wishing to achieve an 'all or nothing' outcome can limit the period of the bid and/or employ minimum acceptance conditions. However,

⁶⁴ 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.

⁶⁵ 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 142 at [RG 142.52].

⁶⁶ 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.

⁶⁷ s 624(1)(b).

confining the period of the bid may reduce its chances of success. Also, minimum acceptance conditions can sometimes work against a bid succeeding (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 necessary level of entitlement to achieve complete control (if that is the goal)

- ***the 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 2.5).

2.3.3 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.⁶⁸ 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,⁶⁹ or in response to the emergence of a rival bidder or changes to the

⁶⁸ 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.

⁶⁹ For instance, in *Alinta Limited* [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.

consideration to be offered.⁷⁰ Also, the court has a discretion to approve a scheme that has been altered after shareholder approval⁷¹

- ***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 there is a common director between the intending controller and the scheme company.⁷² A similar obligation applies to bids.⁷³ However, there is also a strong expectation that shareholders of a scheme should receive an expert's report in all other circumstances.⁷⁴ 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 provisions⁷⁵ or that ASIC has provided a 'no objection' statement.⁷⁶ The court does not have to

⁷⁰ 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 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 target company in response to the emergence of a rival takeover bid after the first court hearing. See also *Excel Coal Limited* [2006] FCA 1383.

⁷¹ 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 *Re Investorinfo Limited* (2006) 24 ACLC 44 at [7], the Court observed that:

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.

⁷² Corp Regs Schedule 8, Part 3, rules 8303 and 8306.

⁷³ s 640.

⁷⁴ ASIC Regulatory Guide 142 at [RG 142.40] recommends an independent expert's report in any scheme to remove minority shareholders.

Damian & Rich, *supra*, at 128–129 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.

⁷⁵ s 411(17)(a).

⁷⁶ s 411(17)(b).

be satisfied on both matters.⁷⁷ These matters are further discussed below (Section 2.4.2). 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 documentation⁷⁸ and raises any disclosure or other concerns with the scheme proponents and, where appropriate, with the court.⁷⁹ ASIC has also identified various 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

⁷⁷ 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.

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).

⁷⁸ 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 ASIC has been given a reasonable opportunity to examine the terms of a proposed scheme and draft explanatory statement and make any submissions to the court: *Re NRMA Ltd* (2000) 33 ACSR 595 at [26], *Re Australian Gas Light Co* (2006) 56 ACSR 659.

⁷⁹ ASIC Regulatory Guide 142 at [RG 142.4] states that the role of ASIC is:

to assist the Court to review the contents of scheme documents and the nature and functioning of the scheme, and in many cases, represent the interests of investors and creditors where ASIC may be the only party before the Court other than the applicant. ASIC also has a role in ensuring that all matters which 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.

shareholders.⁸⁰ ASIC has no corresponding statutory review function with a bid

- ***role of the court.*** The court has a broad supervisory role in relation to proposed schemes, reflected in the requirement that a scheme, even when approved by shareholders, can be implemented only if also approved by the court. The court may grant approval with or without amendments or conditions⁸¹ (see further Section 2.4.2 and 2.5.2: ***general court discretion***).

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.⁸² The Panel may refer to the court a question of law arising in any proceedings before it.⁸³ 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.⁸⁴

2.4 Comparison of scheme and bid protective provisions

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

2.4.1 Bids

Bids are regulated by reference to general shareholder protective objectives, known as the Eggleston principles.⁸⁵ 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

⁸⁰ ASIC Regulatory Guide 142 at [RG 142.35]-[RG 142.40].

⁸¹ s 411(4)(b) (the approval power) and s 411(6) (the variation power).

⁸² s 657C.

⁸³ s 659A.

⁸⁴ s 659B.

⁸⁵ 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.

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
- 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 class⁸⁶
- the terms of all the offers in an off-market bid must be the same⁸⁷
- 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 bid⁸⁸
- the bidder, or associate, must not enter into escalation agreements⁸⁹
- the bidder, or an associate, must not offer collateral benefits⁹⁰
- the consideration in an off-market bid will automatically be varied to reflect any higher cash price paid by the bidder outside the bid during the bid period⁹¹

⁸⁶ s 618.

⁸⁷ s 619. Some exceptions are permitted under s 619(2), (3).

⁸⁸ s 621(3).

⁸⁹ s 622.

⁹⁰ s 623.

- the bidder must not include discriminatory conditions in the bid.⁹²

In deciding whether to exercise its powers to exempt or modify prescriptive or proscriptive bid requirements in a particular case, ASIC must have regard to the Eggleston principles in s 602.⁹³

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 602.⁹⁴ 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.⁹⁵ There are no statutory 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.⁹⁶

2.4.2 Schemes

There is no statutory equivalent in the scheme provisions of the Eggleston principles or the specific 'equality of opportunity' rules that apply to bids.⁹⁷

However, in exercising its general powers over schemes, a court can consider, in addition to other factors (discussed in Section 2.5.2), various matters that bear particularly upon the interests of shareholders in a change of control scheme.

For instance, the court can consider whether to approve a change of control scheme that contains 'lock-up' devices, (such as 'break fees'

⁹¹ s 651A.

⁹² s 627.

⁹³ s 655A(2).

⁹⁴ s 657A(3)(a)(i).

⁹⁵ s 657C(2).

⁹⁶ s 657D(2)(d).

⁹⁷ 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 which had characteristics resembling an escalation agreement which, in a bid, would be prohibited under s 622.

and 'no-shop' and 'no-talk' arrangements⁹⁸) entered into between the target company and the intending controller, given that these arrangements, in some circumstances, could coerce shareholders into agreeing to a scheme or reduce the possibility of an auction for control. Also, the court may need to be satisfied that the proposed scheme has been properly examined by the target company through

⁹⁸ 'Lock-up' devices, which are common in change of control schemes, include 'break fees' (a fee payable by the target company to the intending controller to reimburse for due diligence, transaction and opportunity costs if, in certain circumstances, the scheme does not proceed) and exclusivity provisions (such as 'no-talk' and 'no-shop' arrangements, being a promise by the target company directors not to engage in discussions or negotiations with a third party with a view to soliciting a competing acquisition proposal).

The courts recognise that 'no-talk' and 'no-shop' arrangements 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 discharge of directors' duties and are given adequate prominence in the materials sent to shareholders: *Re Arthur Yates & Co Ltd* (2001) 36 ACSR 758 at [9].

See also *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 [34]-[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 Limited* [2008] NSWSC 323 at [18]-[21], *Re Dyno Nobel Limited* [2008] VSC 154 at [26].

Justice KE Lindgren of the Federal Court, in his paper *Private Equity and Section 411 of the Corporations Act 2001 (Cth)* (International Bar Association/Law Council of Australia Conference, April 2008), 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.

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.

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.

A commentary on developments in the case law on lock-up devices is found in HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.071]. See also A Colla 'Scheme warfare: navigating contests for control in friendly takeover schemes' (2008) 26 *Company and Securities Law Journal* 191.

due diligence.⁹⁹ 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').¹⁰⁰ A court may also need to consider the arrangements for the transfer of any encumbered shares.¹⁰¹

Also, 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 Act¹⁰² (the purpose test)¹⁰³ or that ASIC has provided a 'no objection' statement.¹⁰⁴

The purpose test 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, including that the arrangement is too complex to be implemented simply 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

⁹⁹ *Re Adelaide Bank Limited* [2007] FCA 1582 at [35]: 'I am also satisfied that the [target company] put in place a due diligence committee which has rigorously examined the proposed merger.'

¹⁰⁰ *Re Tempo Services Ltd* (2005) 53 ACSR 526, *Re SFE Corporation Ltd* (2006) 59 ACSR 82, *Re WebCentral Group Ltd* [2006] FCA 937, *Re APN News & Media Ltd* (2007) 62 ACSR 400 at [23], *Investa Properties Limited* [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]. 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].

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].

¹⁰¹ *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 Limited* [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].

¹⁰² In *Macquarie Private Capital A Limited* [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.

¹⁰³ s 411(17)(a).

¹⁰⁴ s 411(17)(b).

acceptance condition.¹⁰⁵ In practice, it seems to be relatively easy to provide appropriate reasons for proceeding through a scheme.¹⁰⁶ Furthermore, 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.¹⁰⁷

The key question ASIC considers in deciding whether to lodge a 'no objection' statement 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 to schemes.¹⁰⁸ ASIC will not object to using a scheme to change

¹⁰⁵ In *Re International Goldfields Ltd* [2004] WASC 112, the Court accepted the 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 NI* [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.

¹⁰⁶ 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.

¹⁰⁷ *Re ACM Gold Ltd* (1992) 7 ACSR 231 at 244 (applied in *Re International Goldfields Ltd* (2003) 21 ACLC 1199 at 1202):

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.

¹⁰⁸ ASIC Regulatory Guide 60 at [RG 60.6, 60.7, 60.13]:

6. The Law sets out the underlying principles of fairness and information for acquisitions of shares in [s 602], ie the Eggleston principles. They relate to sufficient time for shareholders to make a decision, sufficient information to make a decision and reasonable and equal opportunities to share in any benefits that flow from a person acquiring a substantial interest in their company. ASIC will apply those principles equally to its role in schemes of arrangement as it does to other types of acquisitions.

7. ASIC's policy is that shareholders should receive equivalent (although not necessarily identical) treatment and protection whether an acquisition is made under a scheme of arrangement or by any other type of acquisition (including cancellations etc). If those protections are equivalent, ASIC has no policy to favour one legal method over another.

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.¹⁰⁹

A 'no objection' statement from ASIC precludes the court from considering the takeover avoidance purpose issue under s 411(17)(a).¹¹⁰ Also, any consideration of the purpose test will occur at the second court hearing.¹¹¹ However, even where there is a 'no objection' statement, a court may still be able to consider the takeover avoidance purpose issue in the exercise of its general discretion whether to approve a scheme.¹¹²

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

13. The basic question ASIC will consider is whether shareholders are adversely affected by the takeover being implemented by scheme of arrangement, compared to a takeover scheme. It is not whether the purpose of the scheme is to avoid making the acquisition under Ch 6 for reasons which do not adversely affect offerees. ASIC will not intervene, under s 1330, to oppose an application before the court under s 411 on grounds arising out of s 411(17) unless it has concerns in respect of the disclosure requirements or the Eggleston principles. However, ASIC may still make submissions as *amicus curiae* if there are issues to be brought to the attention of the court where ASIC does not oppose the Scheme proposal.

¹⁰⁹ ASIC Regulatory Guide 142 at [RG 142.19]:

ASIC is concerned to ensure that takeovers that operate by way of schemes of arrangement operate, and are regulated, in a manner which is harmonious with the [bid] provisions. This requires that members receive all material information that they need for their decision, members receive reasonable and equal opportunities to share in the benefits provided under the scheme, and the meetings are properly conducted.

¹¹⁰ *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.

¹¹¹ *Macquarie Private Capital A Limited* [2008] NSWSC 323 at [23]-[31].

¹¹² 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)'.

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).

ASIC itself, can apply to the Takeovers Panel for a declaration of unacceptable circumstances'.¹¹³

2.5 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.

2.5.1 Bids

A bid is successful when shareholders holding a sufficient number of shares have accepted the offer in the required manner.¹¹⁴ 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 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 some 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 2.4.1), 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 (and 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

¹¹³ s 657C(2).

¹¹⁴ 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).

bidder offered to acquire under the bid.¹¹⁵ When this combined threshold is reached, or the court otherwise permits,¹¹⁶ 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 securities¹¹⁷

- **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.¹¹⁸ If one or more persons who together hold at least 10% of the remaining shares object, the bidder cannot proceed to compulsory acquisition without obtaining court approval.¹¹⁹

2.5.2 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 may 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. Equally, however, one or more dissenting shareholders who hold a significant, but still

¹¹⁵ 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.

¹¹⁶ s 661A(3).

¹¹⁷ s 661E.

¹¹⁸ 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.

¹¹⁹ ss 664E, 664F.

minority, proportion of the company's shares may in some circumstances be able to block a scheme.¹²⁰

One judicial view is that 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.¹²¹

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

- ***the class voting system.*** Each class of shareholders must approve a scheme, where there is more than one class.¹²² 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'.¹²³ The test has been applied by reference to the rights or interests of shareholders to be varied

¹²⁰ 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*, at 83–86 outline and analyse a table that indicates that the total percentage of issued shares required to approve a scheme under the voted shares test increases above 75% in proportion to the percentage of shares held or controlled by the bidder (given that any shares held or controlled by the bidder 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 further 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:

... 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.

¹²¹ *Re Matine Ltd* (1998) 28 ACSR 268 at 295.

¹²² The votes of different meetings of the same class can be aggregated: s 411(5).

¹²³ *Sovereign Life Assurance Company v Dodd* [1892] 2 QB 573 at 583.

under the scheme.¹²⁴ 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. These other shareholders would have to approve the scheme by a separate class meeting.¹²⁵ 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.¹²⁶ Equally, however, a court may approve a scheme where separate class meetings were not held but it is apparent that the scheme would still have been approved if the proper procedure had been followed¹²⁷

- **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 to effect a change of control 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 bid. Also, a reasonable opportunity must

¹²⁴ 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.

Separate shareholder meetings were ordered in *Re CMPS & F Pty Ltd* (1997) 24 ACSR 728. See also *Re Hills Motorway Ltd* (2002) 43 ACSR 101, *Re HIH Casualty and General Insurance Ltd* (2006) 57 ACSR 791 at [12], and ASIC Regulatory Guide 142 at [RG 142.43]-[RG 142.45].

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.

¹²⁵ 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 142 at [RG 142.46], is that, if the vote is to demonstrate approval by the remaining shareholders, interested parties should 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.

¹²⁶ *Re Chevron (Sydney) Limited* [1963] VR 249 at 255, as applied, for instance, in *Re Citect Corporation Ltd* (2006) 56 ACSR 663 at [30].

¹²⁷ cf *Re Crusader Ltd* (1995) 17 ACSR 336.

be given at shareholder meetings to debate the scheme.¹²⁸ The bid procedure contains no similar statutory requirement for shareholders to meet

- **right of dissidents to go to court.** Shareholders opposing a scheme, even if it is approved at the shareholder meetings, may object at the subsequent second court hearing on whether to approve the scheme.¹²⁹ 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 them¹³⁰
- **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.¹³¹ It is not the role of the court to usurp the decision of shareholders by imposing its own commercial judgment on the scheme,¹³² nor to satisfy itself that no better scheme could have been devised.¹³³ However, a court is not bound by a decision of the shareholders in favour of the

¹²⁸ *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.

¹²⁹ *Re Central Pacific Minerals NL* [2002] FCA 239 at [31].

¹³⁰ *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.

¹³¹ The court can exercise its powers under s 1322 to cure procedural irregularities. 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].

¹³² *Re GIO Australia Holdings Ltd* (1999) 33 ACSR 283 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.

¹³³ *Re Foundation Healthcare Ltd* (2002) 42 ACSR 252 at [44].

scheme.¹³⁴ The courts have developed various principles to take into account in exercising their judicial discretion,¹³⁵ including:

- whether shareholders have voted in good faith and not for an improper purpose¹³⁶
- whether the proposal is fair and reasonable in that ‘an intelligent and honest man, who is a member of [the relevant] class, and acting alone in respect of his interest as such a member, might approve of it’¹³⁷

¹³⁴ *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.

¹³⁵ 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].

¹³⁶ *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’.

¹³⁷ *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:

- 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 discretion¹³⁸
- whether there has been full and fair disclosure to shareholders of all information material to their decision whether to approve the scheme.¹³⁹ A court may decline to permit a meeting of shareholders, or to approve a scheme, if the disclosure is defective.¹⁴⁰ The court may order further disclosure to shareholders, or further shareholder meetings,

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.

¹³⁸ *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) 33 ACSR 283, 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].

¹³⁹ 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 Bohisi Gold NL (No 2)* [2007] FCA 2078 at [40]-[43].

¹⁴⁰ *Re StateWest Credit Society Ltd* (2005) 56 ACSR 453, upheld at 56 ACSR 613.

if there is a material change in circumstances after the initial court order for the meetings or after the shareholder meetings¹⁴¹

- whether minority shareholders would be oppressed under the scheme¹⁴²
- whether the interests of other groups who are not parties to, but are affected by, the scheme are appropriately dealt with¹⁴³
- whether the scheme offends public policy.¹⁴⁴

The court may also require in particular cases that further procedures be undertaken before it will approve a scheme.¹⁴⁵

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

¹⁴¹ 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.

¹⁴² 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.

¹⁴³ For instance, in *In the matter of Stork ICM Australia 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.

¹⁴⁴ *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.

¹⁴⁵ These additional procedures 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).

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.¹⁴⁶

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 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.¹⁴⁷

- ***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.¹⁴⁸ 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.¹⁴⁹

2.6 Share capital reduction

2.6.1 Role in changing control

A reduction of share capital under ss 256B–256E may be undertaken for various purposes, including to achieve a change of control, either through a reduction alone or as part of a scheme. For instance, a

¹⁴⁶ *Re National Bank Ltd* [1966] 1 All ER 1006 at 1013.

¹⁴⁷ *Re Colonial First State Property Trust Group (No 1)* (2002) 43 ACSR 143 at [88]-[89].

¹⁴⁸ *St Barbara Mines Ltd* [2000] ATP 10 at [21].

¹⁴⁹ *id* at [30]-[32].

scheme is needed in addition to a reduction of capital if the intention is to require the affected shareholders to acquire shares in another company.¹⁵⁰ A scheme that includes a reduction of capital must also comply with the statutory procedures for a capital reduction.¹⁵¹ However, 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.¹⁵² The choice between a scheme and a capital reduction may be influenced by various factors including taxation considerations.¹⁵³

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.¹⁵⁴ This form of reduction requires only a simple majority ordinary resolution, with all shareholders being entitled to vote, given that all shareholders are

¹⁵⁰ *Re Hunter Resources Ltd* (1992) 7 ACSR 436, *Alinta Ltd* [2007] FCA 1416. See also ASIC Regulatory Guide 60 at [RG 60.4].

¹⁵¹ *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, ASIC Regulatory Guide 142 at [RG 142.58].

¹⁵² In *Nicon 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.

¹⁵³ 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.

¹⁵⁴ 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 prevented in specie distributions.

to be treated in a similar manner.¹⁵⁵ An equal reduction may be one element of a scheme.¹⁵⁶

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.¹⁵⁷

There are various requirements applicable to a selective and an equal reduction, including that:

- the reduction must not be inconsistent with the company's constitution or shareholder class rights¹⁵⁸
- shareholders must be provided with all information known to the company that is material to the decision on how to vote on the resolution¹⁵⁹
- the reduction must be 'fair and reasonable to the company's shareholders as a whole'¹⁶⁰
- the reduction must not materially prejudice the company's ability to pay its creditors.¹⁶¹

2.6.2 Approval process for a selective reduction

Two special resolutions, each employing a shares test, are required for a selective reduction of shares,¹⁶² the second resolution creating a hurdle for an intending controller:

- the first special resolution excludes any votes in favour of the cancellation resolution by shareholders whose shares are to be cancelled. This ensures that the resolution is not passed through the influence of those who stand to receive some payment or

¹⁵⁵ s 256C(1).

¹⁵⁶ See, for instance, *Re ETRADE Australia Ltd* (1999) 30 ACSR 516, *Re AMP Ltd* [2003] FCA 1465.

¹⁵⁷ *Re Goldfields Kalgoorlie* (2000) 34 ACSR 737 at [5] comments on the use of selective reductions of capital to eliminate minority shareholdings.

¹⁵⁸ See s 256E, notes 6 and 7.

¹⁵⁹ s 256C(4).

¹⁶⁰ s 256B(1)(a).

¹⁶¹ s 256(B)(1)(b).

¹⁶² s 256C(2).

other consideration from the reduction (which might otherwise be too generous).¹⁶³ Intending controllers can vote their shares on this resolution, as those shares will not be cancelled under the reduction

- the second special resolution is confined to shareholders whose shares are to be cancelled. In a prospective change of control, the future controller cannot participate or vote at that meeting, 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.

2.6.3 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, incomplete or misleading disclosure or that the terms of the proposed reduction are not fair and reasonable to the shareholders generally.¹⁶⁴ Unlike the general practice with schemes,¹⁶⁵ an objector may have to pay costs in some circumstances.

ASIC may seek an injunction to restrain possible breaches of the reduction of capital requirements¹⁶⁶ or may intervene in any court proceedings challenging a reduction of capital.¹⁶⁷ Also, ASIC or any

¹⁶³ *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.

¹⁶⁴ s 1324, as referred to in s 256E, note 2.

¹⁶⁵ See text related to footnote 130.

¹⁶⁶ s 1324.

¹⁶⁷ s 1330.

other interested party may apply to the Takeovers Panel if it appears that unacceptable circumstances may have occurred in relation to a reduction of capital, having regard to the effect of the transaction on control of a company.¹⁶⁸

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 shareholders¹⁶⁹
- it is not the role of the court to determine the commercial merits of the reduction¹⁷⁰
- the adequacy of the consideration to be given for shares subject to the reduction is an important factor in determining possible prejudice.¹⁷¹

2.7 Focus on schemes

This chapter has drawn comparisons between the use of schemes, bids and share capital reductions to effect a change of control in a company. Subsequent chapters discuss a range of issues and canvass possible changes to the scheme provisions, including to s 411(17), that would affect change of control schemes.

The Committee has not gone 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 references to bids are made by way of comparison, the focus of this paper is on schemes.

¹⁶⁸ s 657C(2).

¹⁶⁹ *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.

¹⁷⁰ *Catto v Ampol Ltd* (1989) 15 ACLR 307 at 321–322, *Ramsay Health Care Ltd v Elkington* (1992) 7 ACSR 73 at 77–78.

¹⁷¹ *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.

3 Information to shareholders

This chapter discusses requirements for the disclosure of information to shareholders in relation to schemes, the appropriate liability standard and defences for disclosure breaches, and the criterion to be applied by an expert in preparing an opinion on a scheme.

3.1 Effective disclosure

The notice of a scheme meeting that is given to shareholders must contain a statement 'explaining the effect of the compromise or arrangement',¹⁷² include prescribed information¹⁷³ 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'.¹⁷⁴ There is no express requirement on directors under Part 5.1 to go further and make inquiries.

3.1.1 Content of disclosure

The courts recognise that the need to make full and fair disclosure to shareholders should be assessed 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.¹⁷⁵ The court may excuse a defective disclosure or other procedural irregularity.¹⁷⁶

¹⁷² 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.

¹⁷³ s 412(1)(a)(ii), Corp Reg 5.1.01(1)(b) and (c) and Corp Regs Schedule 8 Parts 3 and 4.

¹⁷⁴ 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'.

¹⁷⁵ *Re Crusader Ltd* (1995) 17 ACSR 336 at 343.

¹⁷⁶ 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 often voluminous and complex, thereby increasing administrative costs without necessarily assisting shareholders to understand the matters on which they are to vote. Contributing factors may be 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'¹⁷⁷
- do not have the equivalent of the short-form prospectus provisions, which in some cases allow for incorporation of information in documents by reference¹⁷⁸

though the court may have some discretion to permit abbreviated disclosures.¹⁷⁹

The introduction of a 'clear, concise and effective' requirement for the explanatory statement, and provision for incorporation of information by reference in scheme documents, might contribute to

¹⁷⁷ For instance, ss 249L(3), 715A, 942B(6A), 942C(6A), 1012G(3A), 1013C(3).

¹⁷⁸ Compare s 636(1)(g), which applies the incorporation by reference prospectus provision (s 712) to a bidder's statement.

¹⁷⁹ 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 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.

the provision to shareholders of shorter and less complex documents and assist them to understand the scheme proposal on which they are asked to vote.

A related issue is whether the specific disclosure obligations, set out in Corp Regs Schedule 8 Part 3, should be omitted (given the general disclosure requirement on directors) or alternatively be revised to be more consistent with the required content of bid documents.¹⁸⁰

Damian & Rich have proposed that, given the general disclosure requirements in s 412, the Schedule 8 provisions be repealed, other than those concerning the directors' recommendation¹⁸¹ and the requirements relating to the independent expert's report,¹⁸² with both sets of requirements to be included in the scheme provisions of the Corporations Act.¹⁸³

3.1.2 Method of disclosure

Currently, the explanatory statement must be included in the notice to shareholders of their meeting or meetings.¹⁸⁴ One possibility to reduce costs would be to provide that, while the complete information must be lodged with ASIC, shareholders need only receive a brief 'roadmap' of that information, together with a reference to a website (arranged by the company) where the full information is available. Also, to assist shareholders, the information on the website could be presented in summary form, with links to more detailed information on particular matters (for instance, accounting information) for interested shareholders.

3.2 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

¹⁸⁰ s 636 (content of bidder's statement) and s 638 (content of target's statement).

¹⁸¹ Schedule 8, rule 8301(a).

¹⁸² Schedule 8, rules 8303, 8306.

¹⁸³ Damian & Rich, *supra*, at 115–116.

¹⁸⁴ s 412(1).

have made their decision and the court has decided at the second hearing whether to approve the scheme.¹⁸⁵

In the case of bids, there is a statutory regime for supplementary disclosure by bidders and targets.¹⁸⁶ There is no equivalent procedure for schemes, though the court may be able to approve a process for supplementary disclosures under its first hearing powers.¹⁸⁷ It is unclear whether companies must first approach the court (or ASIC) before releasing supplementary information.¹⁸⁸

Damian & Rich have argued that, to provide certainty and structure, the scheme provisions should be amended to incorporate a supplementary disclosure regime similar to that in a bid.¹⁸⁹ 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.

3.3 Liability and defences for disclosure breaches

The preparation by a company of an explanatory statement for a scheme is subject to the general misleading or deceptive conduct provisions.¹⁹⁰ A person who suffers loss or damage through a disclosure breach may recover from the company or any other person 'involved' in the contravention.¹⁹¹ There are no statutory 'due diligence' defences, though the court has some power to relieve a person from a civil penalty liability.¹⁹²

By contrast, bid documents (as well as fundraising documents) are subject to a specific liability and 'due diligence' defence regime for

¹⁸⁵ *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].

¹⁸⁶ ss 643-647.

¹⁸⁷ *Mincom Ltd v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at [12].

¹⁸⁸ 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).

¹⁸⁹ Damian & Rich, *supra*, at 136-137.

¹⁹⁰ s 1041H(1) and ASIC Act s 12DA(1).

¹⁹¹ s 1041I(1) and s 79 of the Corporations Act, s 12GF(1) of the ASIC Act.

¹⁹² s 1317S(2).

defective disclosures,¹⁹³ to the exclusion of the general misleading or deceptive conduct provisions.¹⁹⁴

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 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.¹⁹⁵

3.4 Formulation of the 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.¹⁹⁶ This contrasts with the formulation in a bid, namely whether the takeover offers 'are fair and reasonable'.¹⁹⁷

Various judicial decisions have noted that some independent experts construe the term 'best interests' as having a similar meaning to 'fair and reasonable'.¹⁹⁸ However, it has been argued that, given the 'functional equivalence' between schemes and bids, it is undesirable that experts may be required to articulate different opinions, depending on the transaction structure used.¹⁹⁹

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

¹⁹³ For bids: ss 670A–670F. For fundraising documents: ss 728–733.

¹⁹⁴ For bids and fundraising documents, s 1041H(3) and ASIC Act s 12DA(1A).

¹⁹⁵ Damian & Rich, *supra*, at 117.

¹⁹⁶ See Corp Regs Schedule 8 Part 3, rule 8303.

¹⁹⁷ s 640(1).

¹⁹⁸ *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 which 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' within the context of takeover bids.

¹⁹⁹ Damian & Rich, *supra*, at 127, 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'.²⁰⁰ In other contexts, such as s 181, a 'best interests' requirement does not impose a 'best possible' standard.²⁰¹

3.5 Request for submissions

The Advisory Committee invites comments on any aspect of the matters raised in this chapter, including:

- possible changes to facilitate effective disclosure of scheme information to shareholders, including in relation to the content and method of disclosure (Section 3.1)
- whether there should be greater statutory guidance concerning supplementary disclosure (Section 3.2)
- whether the liability and defences for disclosure breaches for schemes should be similar to those for bids (Section 3.3)
- whether the required standard for formulation of an expert's opinion should be more consistent between bids and schemes (Section 3.4).

²⁰⁰ McDonald, Moodie, Ramsay and Webster, *Experts' Reports in Corporate Transactions* at 64.

²⁰¹ RP Austin, HAJ Ford & IM Ramsay, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 2005) at 7.2.

4 Voting on schemes

This chapter outlines proposals that have been put forward for changes in voting by class and sets out a range of policy options in relation to the headcount test.

4.1 Class voting

4.1.1 Current position

A scheme requires the approval of shareholders, with separate class voting where there is more than one class. The principles for determining a class have been developed through judicial decision (refer Section 2.5.2: *the class voting system*).

Currently, it is a matter for the company to determine whether it has classes of shareholders. A company may seek directions from the court at the first hearing on the proper constitution of classes. 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.

4.1.2 Suggestions for change

First hearing

Damian & Rich propose that the court 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.²⁰² Arguably, this would add certainty to the shareholder meeting process and preclude the possibility of these issues emerging for judicial consideration only at the second court hearing, after the meetings.

One 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

²⁰² Damian & Rich, *supra*, at 135.

possibility is to require that shareholders be given advance notification of any application to this effect and an opportunity to make submissions.

Second hearing

Damian & Rich also propose 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 or if extrinsic interests exist which may otherwise result in the court overturning the scheme vote.²⁰³

Intending controller

Damian & Rich also suggest that the position of an intending controller in a change of control scheme be clarified, by specifically disregarding any votes cast in favour of the scheme by that person and any associates of that person.²⁰⁴ Currently, it is expected that such persons either not vote or vote as a separate class.²⁰⁵ A comparable voting exclusion concept is already applied in the context of bids.²⁰⁶

4.2 Headcount test

4.2.1 Current position

A scheme requires approval by shareholders under the voted shares test and the headcount test (see Section 1.3.3). 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.²⁰⁷ 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

²⁰³ *ibid.*

²⁰⁴ *id* at 136.

²⁰⁵ ASIC Regulatory Guide 142 at [RG 142.46]. See also text related to footnote 125.

²⁰⁶ Subparagraph (a)(i) of Item 7 of s 611.

²⁰⁷ 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'.²⁰⁸ The headcount test remained when the scheme provisions were extended to shareholders. The UK legislation retains the headcount test for both forms of scheme,²⁰⁹ notwithstanding a recommendation in a report that it be abolished.²¹⁰

The headcount test in 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.²¹¹

An amendment, now operative, retains the headcount test 'unless the Court orders otherwise'.²¹² 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 group opposed to the scheme may cause the scheme to be

²⁰⁸ 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].

²⁰⁹ *Companies Act 2006* (UK) s 899(1).

²¹⁰ *Modern Company Law: For a Competitive Economy—Final Report* (June 2001) at 278 [13.10].

²¹¹ 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.

²¹² 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.

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.²¹³

The Explanatory Memorandum then stated 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.²¹⁴

The Explanatory Memorandum gave no further guidance on what might constitute 'unforeseen extraordinary circumstances'. Arguably, this suggests a limited application of the court's dispensing powers beyond share splitting.²¹⁵ One possible area may be where a single shareholder holds shares on behalf of a large number of beneficial owners.²¹⁶

4.2.2 Other instances of a headcount test

A headcount test applies to compulsory acquisition pursuant to an offer under s 414 (see Section 1.5.2).

²¹³ para 4.179. Share splitting was considered in *MIM Holdings Ltd* [2003] QSC 181 at [19]. See also ASIC Regulatory Guide 142 at [RG 142.61] and [RG 142.62].

²¹⁴ para 4.181.

²¹⁵ A court might adopt the ASIC policy in regard to share splitting (formulated for the scheme provisions prior to the amendment) that a scheme outcome should not be determined by shareholders who lack even a minimum economic interest as shareholders in the corporate future of the company, being, in the case of a listed public company, a marketable parcel of shares: ASIC Regulatory Guide 142 at [RG 142.62]. The Australian Securities Exchange (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.

²¹⁶ In *pSivida Limited v New pSivida, Inc* [2008] FCA 627, the Court observed, at [11]-[12]:

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'.

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

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.²¹⁷ A poll may be demanded on any resolution (with some limited exceptions).²¹⁸

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 administration²¹⁹ and a lesser role in a liquidation.²²⁰ They vote by number (headcount) as well as by the value of the corporate debt owed to them.²²¹ However, where the voting outcomes differ, the administrator or liquidator may exercise a casting vote.²²² 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 with 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.

²¹⁷ ss 250J(1), 250L.

²¹⁸ s 250K.

²¹⁹ Corporations Act Part 5.3A, in particular Divisions 2, 5 (including s 439C) and 10.

²²⁰ For instance, ss 473(3)(b)(i), 477(2A), (2B), 497, 548.

²²¹ Corp Reg 5.6.21(2), (3).

²²² Corp Reg 5.6.21(4).

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,²²³ as well as the 90% entitlement test²²⁴), 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.²²⁵ 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.²²⁶ 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 the other method of compulsory acquisition.²²⁷

4.2.3 Shareholder voting patterns in schemes

Any consideration of the headcount test in 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.

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). On some occasions 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

²²³ s 661A(1)(b)(ii).

²²⁴ s 661A(1)(b)(i).

²²⁵ [2.31]-[2.58], rec 7.

²²⁶ s 664A.

²²⁷ paras 10.1 ff.

failed under the headcount test if opposed by 12% of a company's shareholders.²²⁸

4.2.4 Policy options for companies limited by shares

Option 1: no change

An argument for no change is that the headcount test gives small shareholders an opportunity to have a significant say in the future nature or structure of a company under a scheme. A company may need to tailor the terms of a proposed scheme to attract their support. From this perspective, 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.²²⁹

A contrary view is that requiring satisfaction of the headcount test can place significant power in the hands of small shareholders, out of proportion to their financial involvement in the company. It can result in a group of persons who together have contributed only 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 with the headcount test, considerable 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 4.2.1). 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 Australia²³⁰ has 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

²²⁸ The data on member voting patterns for 36 successful schemes entered into between 1998 and 2007 were supplied by Macquarie Bank.

²²⁹ See, for instance, *Re Simeon Wines Ltd* (2002) 42 ACSR 454, *Re Normandy NFM Ltd* (2003) 45 ACSR 236.

²³⁰ Law Council of Australia Submission to Treasury on the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007.

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, a reasonable proxy for a minimum economic interest is a marketable parcel of shares.²³¹

Option 3: retain, but modify, the headcount test

The Law Council submission included two issues that could be dealt with by modifying, rather than eliminating, the headcount test. They involved situations where a majority of shareholders under the headcount test opposed the scheme and there is evidence that:

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

²³¹ 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.

- 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.

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.

The problem with accommodating beneficial owners is 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, 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 discretion to dispense with the headcount test would remain.

Option 4: dispense with the headcount test

The Law Council has submitted 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.²³²

The Law Council 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 target shareholders who vote on the scheme.

²³² 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.

However, according to the Law Council 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 uncertainty²³³
- other provisions dealing with shareholder meetings are based upon the principle of 'one share one vote'²³⁴
- as nominees hold a large portion of shares in some listed companies, the headcount test is not indicative of the decisions of the beneficial owners of the shares. The headcount test focuses on registered holders of shares rather than underlying ownership, and thus a nominee can only count as a single member under the test. The headcount test therefore disenfranchises shareholders 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 different ways by different beneficial owners, as the nominee is able to vote each share separately²³⁵
- the CLERP reforms removed the comparable headcount test in the compulsory acquisition provisions for takeovers, as recommended by the Advisory Committee.²³⁶ 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'.²³⁷ This policy reason applies equally to schemes of arrangement.

²³³ The time and cost involved may depend on whether an application to the court to dispense with the headcount test was considered at the first court hearing, at the second court hearing, or as an independent intermediate application.

²³⁴ However, the possibility of non-voting shares in listed companies has been mooted.
²³⁵ s 250H.

²³⁶ *Compulsory Acquisitions* (January 1996) rec 7.

²³⁷ 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 Law Council submission, 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.

Another argument for having only a voted shares test is that the court 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, for instance, 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 2.5.2: **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 abolishing 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 75% of votes cast threshold is reached. However, this shareholder would most likely have to vote in a separate class meeting (see Section 2.5.2: **the class voting system**). Any doubt on this matter might be overcome by a provision that specifically disregards any votes cast by a person whose proportionate share or voting entitlement will increase under the scheme, and any associates of that person (compare Section 4.1.2: *Intending controller*).

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

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

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

- 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.

The first alternative would ensure that a scheme cannot be approved without a very 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 remove one of the main advantages of schemes, that they cannot be defeated through the non-participation of uncontactable, apathetic, or other uninvolved shareholders.

4.2.5 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.²³⁸ In consequence, a scheme for a company 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.²³⁹ 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.²⁴⁰

Simply eliminating the headcount test would leave these companies without a mechanism for member approval of schemes. There would need to be some provision to deal with this situation. 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.²⁴¹

²³⁸ 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).

²³⁹ 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 *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.

²⁴⁰ s 136(2), s 9 definition of 'special resolution'.

²⁴¹ G Durbridge, *Commentary on Tony Damian's Paper on Reforming the Scheme Provisions* (Law Council of Australia, Business Law Section, Corporations Workshop July 2005).

4.3 Request for submissions

The Advisory Committee invites comments on any aspect of the matters raised in this chapter concerning:

- class voting (Section 4.1)
- the headcount test as it applies to companies limited by shares, including the various policy options to retain, modify, dispense with or replace, this test (Section 4.2.4)
- the headcount test as it applies to companies limited by guarantee (Section 4.2.5).

According to G Durbridge, 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.

5 Regulatory and judicial powers

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

5.1 ASIC exemption and modification powers

ASIC has broad powers to exempt or modify many prescriptive and proscriptive requirements for bids.²⁴² By contrast, ASIC's dispensing and consent powers with schemes are confined to the disclosure requirements.²⁴³

Damian & Rich²⁴⁴ have suggested that ASIC's role in schemes be expanded to give it general exemption and modification powers for the scheme provisions, equivalent to those it has for bids. This would also raise the question whether any appeal from ASIC's exercise of those powers should be to the Administrative Appeals Tribunal or to the Takeovers Panel.²⁴⁵

A contrary view is that the ASIC exemption and modification powers under the bid provisions reflect the need to add flexibility to very 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 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.

²⁴² s 655A. In exercising those powers, ASIC must have regard to the Eggleston principles in s 602 regarding the regulation of bids.

²⁴³ Corp Reg 5.1.01 and Corp Regs Schedule 8 Part 3, rule 8305.

²⁴⁴ Damian & Rich, *supra*, at 129.

²⁴⁵ 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)).

However, an ASIC exemption power of this nature may be unnecessary if the further step is taken of introducing a short-form merger procedure for wholly-owned corporate groups that would not require shareholder approval (Section 6.3).

5.2 Purpose and comparable protections tests

5.2.1 Background

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

This issue arose in the context of cases where the court for the first time examined the interrelationship between scheme and bid provisions in achieving a change of control. The decisions in those cases recognised a scheme as a legitimate alternative to a bid for this purpose.²⁴⁶

One view was that all change of control transactions should proceed through a bid, thereby achieving a uniformity of approach. This policy would overcome any possibility of regulatory arbitrage whereby a bidder might choose a scheme simply because of the perceived easier shareholder approval threshold or to avoid the equality of opportunity or other regulatory protections for shareholders that were being written into the takeovers laws.

A contrary view was that it was impractical to force each change of control transaction through the bid mechanism, particularly if it was part of a more complex corporate reorganization. To do so might also encourage the use of artificial structures or devices to justify use of a scheme. Also, in considering whether to approve a change of

²⁴⁶ 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.

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).²⁴⁷ 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, the court retains its general discretion whether to approve a scheme,²⁴⁸ which may include a consideration of the purpose of the scheme.²⁴⁹

As earlier indicated (Section 2.4.2), 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 control may choose a scheme over a bid, at least where there is some commercial justification for that choice and the target company is prepared to put the change of control proposal to a shareholders' meeting.

5.2.2 Proposal to repeal s 411(17)

Damian & Rich²⁵⁰ argue 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

²⁴⁷ Damian & Rich, *supra*, in Chapter 3, 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.

²⁴⁸ s 411(4)(b), (6).

²⁴⁹ See footnote 112.

²⁵⁰ Damian & Rich, *supra*, at Section 7.2.

known until after the great expense of the scheme process has been incurred.²⁵¹

They also argue that:

Schemes serve a very useful role in the market for corporate control and there are comprehensive protections for dissentients and minorities inherent in the scheme process. At the very minimum, Chapter 5 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.²⁵²

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:

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.²⁵³

Another commentator has questioned what practical function s 411(17) serves, given that no court has rejected a scheme under this 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.²⁵⁴

Damian & Rich argue that technical 'equality of opportunity' rules drawn from the bid provisions (see Section 2.4.1) and other restrictions on bids, such as the prohibition on conditions requiring payments to officers of the target²⁵⁵ or self-activated defeating conditions,²⁵⁶ 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

²⁵¹ id at 101.

²⁵² id at 102.

²⁵³ ibid.

²⁵⁴ 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.

²⁵⁵ s 628.

²⁵⁶ s 629.

is a fully informed disinterested vote where the equality of opportunity principle would otherwise be compromised.²⁵⁷

This approach was taken in *Re Ranger Minerals Ltd* (2002) 42 ACSR 582, where the Court approved a scheme, even though the minimum bid price principle applicable to bids had been departed from, 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.²⁵⁸ 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]).

²⁵⁷ 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).

A similar analysis is also found in Damian & Rich, *supra*, at 109ff.

²⁵⁸ 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.

A similar approach was taken in a subsequent decision where the same issue arose.²⁵⁹

The proposed repeal of s 411(17) would affect the objection rights of ASIC under s 411(17)(b). Damian & Rich acknowledge this consequence:

The consequences 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, 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.²⁶⁰

However, Damian & Rich argue 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, a breach of the disclosure provisions in Chapter 5, class composition, extrinsic interests or fairness would, of course, remain open to ASIC and objectors.²⁶¹

5.2.3 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.²⁶²

Currently, the court can take comfort from the ASIC 'no objection' statement that ASIC has closely considered the matters set out in the ASIC Regulatory Guides, including the application of the Eggleston

²⁵⁹ 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.

²⁶⁰ Damian & Rich, *supra*, at 102.

²⁶¹ *ibid.*

²⁶² s 1330.

principles,²⁶³ so that shareholders in a scheme receive equivalent, though not necessarily identical, treatment and protection as under a bid:

ASIC is concerned to ensure that takeovers that operate by way of schemes of arrangement operate, and are regulated, in a manner which is harmonious with the [bid] provisions. This requires that members receive all material information that they need for their decision, members receive reasonable and equal opportunities to share in the benefits provided under the scheme, and the meetings are properly conducted. ASIC will not provide a statement under s 411(17)(b) unless the scheme and its explanatory statement meet these conditions.²⁶⁴

5.2.4 Proposal to amend s 411(17)

One commentator, George Durbridge,²⁶⁵ has suggested rewording s 411(17) specifically to include the Eggleston principles for change of control schemes, rather than adopt technical equality of opportunity or other procedural rules drawn from the bid provisions (see Section 2.4.1). 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 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.

²⁶³ See text accompanying footnote 108.

²⁶⁴ ASIC Regulatory Guide 142 at [RG 142.19].

²⁶⁵ G Durbridge, *Commentary on Tony Damian's paper on reforming the scheme provisions*, Law Council of Australia, Business Law Section, Corporations Workshop July 2005.

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

Durbridge further proposes that, to facilitate the consideration of the scheme and its documentation under this 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.²⁶⁶

To ensure full disclosure:

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.²⁶⁷

²⁶⁶ *ibid.*

²⁶⁷ *ibid.*

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.²⁶⁸

5.3 Request for submissions

The Advisory Committee invites comments on any aspect of the matters raised in this chapter, including:

- whether there should be some change to the ASIC exemption and modification powers in regard to schemes (Section 5.1)
- whether s 411(17) should be:
 - repealed (Section 5.2.2)
 - retained in its present form (Section 5.2.3), or
 - amended (Section 5.2.4).

²⁶⁸ *ibid.*

6 Extension and simplification of schemes

This chapter considers whether the members' scheme provisions should accommodate holders of options over unissued shares or convertible notes, be extended to managed investment schemes, be simplified for mergers within wholly-owned corporate groups and be adapted for use in schemes opposed by the target company.

6.1 Option and convertible noteholders

A company may issue options to subscribe for its shares, for instance to employees as part of their remuneration arrangements. Likewise, a company may issue debt securities that are convertible into shares in specified circumstances.

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.²⁶⁹ Also, holders of corporate debt convertible into equity (noteholders) are creditors.²⁷⁰

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.²⁷¹ Optionholders and noteholders, as creditors, are subject

²⁶⁹ The relevant case law in support of the proposition that optionholders over unissued shares are creditors, including *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), are analysed in HAJ Ford, RP Austin, IM Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Butterworths, looseleaf) at [24.020] **Optionholders** and in *Australian Corporation Law: Principles and Practice* (LexisNexis Butterworths, looseleaf) at [5.1.0035]. In *Re Dyno Nobel Limited* [2008] VSC 154 at [1], the Court approved a separate meeting of holders of options to subscribe for shares to consider a scheme whereby their shares would be acquired for cash.

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.

²⁷⁰ See, for instance, *Re Crown Diamonds NI* [2005] WASC 93 at [28].

²⁷¹ For instance, *Application of Australian Co-operative Foods Ltd* (2001) 38 ACSR 71.

to the headcount test, as well as the value test, in approving a scheme.²⁷²

This raises various questions, including:

- whether optionholders and noteholders should be given some right to participate in members' schemes
- and, if these schemes are so expanded:
 - whether optionholders or noteholders should be treated as separate classes from holders of issued shares
 - whether the legislation needs to clarify the value of options, or convertible notes, for the purpose of the value test²⁷³
- and, if optionholders and/or noteholders remain as creditors:
 - whether the discretion given to the court under the 2007 amendment to dispense with the headcount test for shareholders should also apply to voting by optionholders or noteholders
 - whether any other possible amendments to the headcount test (as set out in Section 4.2.4) should also apply to voting by optionholders or noteholders.

6.2 Managed investment schemes

6.2.1 Listed managed schemes

Listed managed investment schemes (listed managed schemes) form a significant portion of the commercial market. For instance, listed property trusts represent about 10% of the ASX index. There has been a considerable growth in the number and market capitalisation of listed managed schemes (driven in part by the growth of

²⁷² s 411(4)(a)(i).

²⁷³ Damian & Rich, *supra*, at 123–127 point out that a problem in valuing options can arise where options are issued in a number of tranches and may have different exercise prices and expiry dates. They argue (at 127) that:

For the same reasons that it is not appropriate to measure shareholders' voting rights by reference to the price at which they acquired their shares, it may be inappropriate to take into account the option exercise price in determining option holders' voting entitlements.

superannuation funds), as well as innovations in their structure, including greater use of 'stapled' as well as 'unstapled' schemes.²⁷⁴

In March 2000, the bid provisions were amended to regulate the acquisition of interests in listed managed schemes, as well as companies.²⁷⁵ However, the scheme provisions do not cover listed managed schemes.²⁷⁶ 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. 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).²⁷⁷ 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.²⁷⁸

There is no equivalent in these 'trust schemes' of the judicial and other procedural protections found in the scheme provisions, though parties seeking to undertake a 'trust scheme' may choose to seek judicial direction or advice on its implementation.²⁷⁹

²⁷⁴ See, for instance, *Macquarie Private Capital A Limited* [2008] NSWSC 323.
²⁷⁵ s 604.

²⁷⁶ 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.

²⁷⁷ The operation of these schemes is further described in *Damian & Rich*, supra, at 120.

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.

²⁷⁸ Item 7 of s 611.

²⁷⁹ *Re Westfield Holdings Ltd* (2004) 49 ACSR 734 at [3], *Macquarie Private Capital A Limited* [2008] NSWSC 323 at [3].

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.²⁸⁰

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 the proposed scheme. The Advisory Committee supported a similar approach in its review in the early 1990s of managed schemes.²⁸¹

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

²⁸⁰ The 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. The Takeovers Panel Guidance Note 15 was developed in consequence of this case.

²⁸¹ 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 should 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].

6.2.2 Unlisted managed schemes

One general question is whether any extension of the scheme provisions should be limited to listed managed schemes.

The only managed schemes that are subject to the bid requirements are those that are listed.²⁸² This reflects the focus of the bid provisions on larger entities.²⁸³ However, on one view, there is no equivalent rationale for limiting any extension of the facilitative scheme provisions to listed managed schemes.

6.3 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 the 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 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*,²⁸⁴ is a short-form merger procedure within wholly-owned corporate groups that would dispense with shareholder involvement and would reduce the role of the court. Its key features are:

- the directors of each affected group company would approve the merger, signing a certificate that they are satisfied that the

²⁸² s 604.

²⁸³ 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.

²⁸⁴ *Corporate Groups* (2000) paras 5.13-5.27 and rec 15.

merger will not materially affect the company's ability to pay its creditors²⁸⁵

- 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 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 power of the court under s 413 to make consequential orders to effect the merger, once approved, would remain.

6.4 Schemes opposed by the company

In theory, any shareholder, as well as the company itself, can propose a scheme, to change control of that company or for any other purpose.²⁸⁶ However, the legislation proceeds on the basis that the company will take responsibility for proposing the scheme, including conducting the scheme meeting.²⁸⁷ 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.²⁸⁸

For the sake of completeness, the Committee asks whether the scheme provisions could or should be adapted to facilitate their use where a target board opposes a scheme 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:

²⁸⁵ 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.

²⁸⁶ s 411(1).

²⁸⁷ Subsection 412(1) states that, where a meeting is convened under s 411, 'the body' [meaning the target company] must send certain information to shareholders.

²⁸⁸ For instance, where an intending controller will offer a considerable premium to shareholders, but only by way of a scheme.

- whether the directors of a target company should be required to co-operate with a scheme proponent that they oppose
- if so, in what manner
- what obligations should be placed on the scheme proponent.

6.5 Request for submissions

The Advisory Committee invites comments on any aspect of the matters raised in this chapter, including whether, and if so in what manner, the scheme provisions:

- might better accommodate holders of options over unissued shares or holders of convertible notes (Section 6.1)
- should extend to listed managed investment schemes (Section 6.2.1) and unlisted managed investment schemes (Section 6.2.2)
- might be simplified for mergers within wholly-owned corporate groups (Section 6.3)
- could be adapted to accommodate the possibility of schemes being initiated otherwise than by the target company (Section 6.4).