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Dear Sir

CAMAC Discussion Paper - Members Schemes of Arrangement

We refer to the CAMAC Discussion Paper titled “Members Schemes of Arrangement” published in June 2008 (**Discussion Paper**).

1 Introduction

This letter is a submission made in response to the following requests for submissions in the Discussion Paper:

- Whether there should be greater statutory guidance concerning supplementary disclosure (Section 3.2).
- Whether s411(17) of the *Corporations Act 2001* (Cth) (**Act**) should be repealed, retained in its present form or amended (Section 5.2).

2 Executive Summary

- A statutory supplementary disclosure regime should be implemented for supplementary disclosure by corporations which have embarked on a scheme of arrangement. The supplementary disclosure provisions in Chapter 6 of the Act may be used as guidance, however, court approval should be required for supplementary disclosure of material new information to members or creditors.
- Schemes of arrangement are recognised as true alternatives to bids under Chapter 6 of the Act. In circumstances where the legislation provides for such a choice, and establishes sufficient protection for members and creditors the subject of a scheme, s411(17) of the Act should be repealed. The effect will be to minimise the uncertainty and completion risk that, at least in recent times, exists at a theoretical level, as in practice, the courts have read down s411(17)(a) and have been ready to accept reasons put forward by scheme proponents as to why a scheme has not been implemented to avoid the bid provisions in Chapter 6 of the Act.

3 Supplementary disclosure

The directors of a corporation which has embarked on a scheme of arrangement have an obligation to disclose to the members or creditors affected by the scheme any material new information occuring after the dispatch of the explanatory statement and notice of meeting and before the scheme is considered by members.[1] Depending on the nature of the new information, a supplementary opinion from the independent expert may also be required[2] and the scheme meeting may need to be adjourned to give members or creditors sufficient time to consider the material new information.

However, ss411 and 412 of the Act do not contemplate a second or subsequent explanatory statement. Nor does the Act require that any proposed supplementary disclosure be lodged with and reviewed by ASIC and approved by the court before its release to members or creditors.

The absence of statutory guidance has created uncertainty amongst scheme proponents as to:

(a) the content, form and timing of the supplementary disclosure;

(b) the impact the supplementary disclosure may have on the timetable for the scheme, and in particular, the scheme meeting;

(c) whether court approval is required for the supplementary disclosure of material new information;

(d) whether a supplementary opinion from the independent expert is required; and

(e) whether court approval is required for supplementary disclosure of new information which is not material, but is nonetheless disclosed to scheme participants.

The absence of statutory guidance has led to conflicting authority on these issues. For example, in *Cleary v Australian Co-Operative Foods Limited (No 2)*[3], Austin J stated that directors are not obliged to obtain the court's approval for the dispatch of supplementary information, however, his Honour suggested that it is prudent to place such materials before the court in circumstances where there is a real possibility of a challenge to the scheme on disclosure grounds at the second court hearing.[4] However, in *Re Australian Co-Operative Foods Limited*[5], Santow J stated that any material new information should be brought to the attention of the court promptly so its implications for the scheme and the scheme company's continuing disclosure obligations can be properly assessed.[6]

The directors' obligation to disclose material new information implies that the supplementary disclosure must be timely. In *Cleary v Australian Co-Operative Foods Limited (No 2)*, Austin J suggested that the court would be unlikely to exercise its discretion

[1] *Cleary v Australian Co-Operative Foods Limited (No 2)* (1999) 32 ACSR 701 at 745.

[2] *Cleary v Australian Co-Operative Foods Limited (No 2)* (1999) 32 ACSR 701 at 723-724.

[3] (1999) 32 ACSR 701.

[4] *Cleary v Australian Co-Operative Foods Limited (No 2)* (1999) 32 ACSR 701 at 745-746.

[5] (2001) 38 ACSR 71.

[6] *Re Australian Co-Operative Foods Limited* (2001) 38 ACSR 71 at 93.

in favour of approving a scheme which has been affected by material new information if the members had not had the opportunity to consider and respond to it.[7]

Ordinarily, information to be considered by members or creditors must be dispatched with sufficient notice – 28 days for a public listed company in the case of a notice of meeting.[8] However, in the case of supplementary disclosure, a balance must be struck between giving members or creditors sufficient time to consider the information and the impact on the timing and cost of the scheme if the scheme meeting is adjourned. In this respect, a period of less that 28 days has been accepted by the courts.[9] Although ASIC has not provided official guidance on the timing of supplementary disclosure of material new information, in practice, ASIC's unofficial policy is to require a period of 10 days between the date of dispatch of the supplementary information and the receipt of proxies for the scheme meeting.

Recommendation

The lack of guidance from the Act and ASIC in relation to the content, form and timing of supplementary disclosure of material new information has had the effect of creating uncertainty and completion risk for scheme proponents due to the potential impact on the timetable for the scheme and the risk of a challenge to the scheme on disclosure grounds at the approval stage. To reduce this uncertainty and bring structure to the supplementary disclosure regime, it is recommended that the scheme provisions be amended to incorporate a supplementary disclosure regime. The supplementary disclosure regime may be modeled on the regime for supplementary bidder's statements and target's statements in Chapter 6 of the Act[10], however, in the same way that court approval is required for the dispatch of the explanatory statement to members or creditors, court approval should also be required for supplementary disclosure of material new information. ASIC review and/or court approval should not be required for supplementary disclosure of new information in relation to a scheme which is not material, but is nonetheless disclosed to members or creditors.

Directions by the court with respect to supplementary disclosure would have the same general effect as the court orders have when they are made at the first hearing in response to an application for the convening of the scheme meeting. That is, the court ought not to give directions with respect to the convening of the scheme meeting unless the scheme is of such a nature and is cast in such terms that, following approval at the meeting, the court would be likely to approve it on an unopposed application.[11] In relation to supplementary disclosure, the principle implies that a court should not direct the dispatch of supplementary disclosure material unless it is of the view that if those materials are dispatched in a timely

[7] *Cleary v Australian Co-Operative Foods Limited (No 2)* (1999) 32 ACSR 701 at 712.

[8] *Corporations Act*, s 249HA(1).

[9] In *Cleary v Australian Co-Operative Foods Limited (No 2)* (1999) 32 ACSR 701 at 712, Austin J considered that it was not unreasonable the scheme company to expect members to respond to materials sent to them within 17 days.; In *Anzon Energy Limited* (25 August 2008 – reasons yet to be published), Lindgren J made orders for the dispatch of supplementary information on 25/26 August 2008 for the scheme meeting held on 3 September 2008 (however, in that case, both the bidder and target were of the view that the new information was not material).

[10] *Corporations Act*, s 643 - s647.

[11] *FT Eastment & Sons Pty Ltd v. Metal Roof Decking Supplies Pty Ltd* (1977) 3 ACLR 69 at 72; *Re Linter Textiles Corp Ltd* [1991] VR 561; (1990) 4 ACSR 99; *Re Price Mitchell Pty Ltd* [1984] 2 NSWLR 273; (1984) 9 ACLR 1; *Re Sonodyne International Ltd* (1995) 15 ACSR 494.

fashion and if the scheme is approved at the relevant meeting or meetings, it would approve the scheme on an unopposed application.[12]

With respect to the timing of supplementary disclosure, the provisions in Chapter 6 require that disclosure be made "as soon as practicable".[13] It is suggested that a similar provision be adopted in relation to schemes, as the time period will depend on factors such as the nature of the material new information and whether or not the information had been foreshadowed and/or referred to in the explanatory memorandum. It is submitted that the court is best placed to determine whether members or creditors will have sufficient time to consider and respond to the supplementary information before the scheme meeting. The court will be assisted in this task if a statutory regime regulating the content of supplementary disclosure is implemented.

4 Section 411(17)

The use of schemes of arrangement to achieve a change of control

The Act provides a choice between Chapter 5 and Chapter 6 to achieve a change of control. The courts have also recognised schemes of arrangement as offering a true alternative to the way in which acquisitions may occur.[14] However, this choice is subject to the operation of s411(17) of the Act, which provides that a court may not approve a scheme of arrangement unless either it is satisfied that the scheme is not for the purpose of avoiding the bid provisions (s411(17)(a)) or ASIC has provided a 'no objection' statement (s411(17)(b)).

ASIC's policy on transactions that can be conducted either under Chapter 5 or Chapter 6 of the Act is that it does not prefer one acquisition structure over the other.[15] However, ASIC will only produce a no objection statement to the court if it is satisfied that all material information relating to the scheme of arrangement has been disclosed and the standard of disclosure in the explanatory memorandum is commensurate with that required under the takeover provisions.[16] In practice s411(17)(b) is being used by ASIC as a means of controlling the level of disclosure in the explanatory memorandum which does not necessarily sit comfortably with the apparent purpose of s411(17) as manifested in s411(17)(a).

In circumstances where schemes have been accepted as a true alternative to the bid regime in Chapter 6 of the Act, the effect of s411(17) has been to create uncertainty to the scheme regime and completion risk for scheme proponents. Much of this uncertainty arose following the judgment of Fryberg J in *Re Mincom Limited [No 3]*,[17] where his Honour held that the court's general discretion under s411(4) allowed the court to consider takeover avoidance issues even if ASIC had provided its certificate under s411(17)(b).[18]

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[12] *Re Symbion Health Limited (No 1, No 2, No 3, No 4)* [2007] VSC 571 (27 November 2007) at [52] – [53].
[13] *Corporations Act*, s647.
[14] *MIM Holdings Limited* (2003) 45 ACSR 554 at 557; *Re Coles Group Ltd (No 2)* [2007] VSC 523 at [22].
[15] ASIC Regulatory Guide 60, para [3].
[16] ASIC Regulatory Guide 60, para [20].
[17] [2007] QSC 207.
[18] At [40] and [30] - [33].

However, in a number of recent scheme cases, s411(17) has been read down by the courts and interpreted in a manner that does not preclude the use of schemes to achieve a change of control.[19]

Further, satisfying the court that a scheme has not been proposed for the purpose of avoiding the bid provisions in Chapter 6 of the Act has been a relatively straightforward task. For example, courts have approved schemes where an element of the transaction could not have been achieved in a bid under Chapter 6, such as:

(a) the need to acquire 100% of the company in a relatively short period of time;[20]

(b) where the scheme involves a cash payment to target shareholders as a result of a reduction of capital;[21]

(c) a cancellation of options in the target;[22]

(d) the complex nature of the transaction;[23]

(e) issues surrounding funding and the need to know for certain by a specified date whether or not the acquisition may proceed;[24] and

(f) greater certainty of timing than was possible under a bid.[25]

Protections available to shareholders

The perceived lower level of protection afforded to members or creditors in a change of control implemented by way of scheme rather than under Chapter 6 is often cited as a reason for maintaining s411(17). The lower level of protection is said to arise from the perceived lower approval threshold, avoidance of the equality of opportunity principle in s602 of the Act and other protections for members that are contained in Chapter 6.[26] However, this argument does not give sufficient weight to the comprehensive protections for minorities and dissidents inherent in Chapter 5, and which are summarised at pages 34 – 40 of the Discussion Paper. A further level of protection to members and creditors is provided by ASIC's role in the review of the explanatory statement and right to appear at the first and second court hearing.

The fact that the scheme application is *ex parte* is also significant. The absence of any defendant or contradictor is said to sharpen the duty of the scheme company, which carries the responsibility of bringing to the court's attention all matters that could be considered relevant to the exercise of its discretion. It is on that basis that the court is entitled to be confident that all relevant material is before the court.[27] The scheme company will be ultimately responsible if it fails to fulfil this duty.

[19] *Re Coles Group Ltd (No 2)* [2007] VSC 523; *Re Lonsdale Financial Group Limited (No 2)* [2007] VSC 525; *Re Hostworks Group Limited* [2008] FCA 64 at [30]; *Anzon Australia Limited, in the matter of Anzon Australia Limited* [2008] FCA 309 at [10].

[20] *Re Crown Diamonds NL* (2005) 54 ACSR 46 at [49]–[50]; *Re International Goldfields Ltd* [2004] WASC 112.

[21] *Re ACM Gold Ltd; Re Mount Leyshon Gold Mines Ltd* (1992) 7 ACSR 231.

[22] *Re Stockbridge* (1993) 9 ACSR 637.

[23] *Re Stockbridge* (1993) 9 ACSR 637.

[24] *Re Ranger Minerals Ltd* (2002) 42 ACSR 582; *MIM Holdings Limited* (2003) 45 ACSR 554.

[25] *Mincom v EAM Software Finance Pty Ltd (No 3)* (2007) 64 ACSR 387 at [46].

[26] Eg, minimum bid price rule (*Corporations Act*, s 621(3)); collateral benefits (*Corporations Act*, s 623).

[27] *Permanent Trustee Company* [2002] NSWSC 1177 at [7]

It is submitted that the equality of opportunity principle is sufficiently addressed in the Chapter 5 regime through the protections referred to at pages 34 – 40 of the Discussion Paper, in particular, the class voting regime. For example, if a bidder engages in conduct which would otherwise infringe the minimum bid price rule if the acquisition were to take place under Chapter 6[28], the bidder will not be able to vote its shares in the same class as other members at the scheme meeting as the bidder's interests will be different to those of the remaining members.[29] It should be noted that the court has accepted that the minimum bid price principle does not apply to schemes of arrangement.[30]

Similarly, if a bidder enters into a voting agreement to vote in favour of the scheme with a member of the target, in circumstances where the agreement would be classified as a collateral agreement under s623 of the Act if the acquisition were to take place under Chapter 6, that agreement may place that shareholder in a separate class distinct from other members. However, even if that member is not placed in a separate class, the court may exercise its general discretion at the approval stage under s411(4) by ignoring the votes cast by the relevant member as part of the court's review of the fairness of the scheme.

It is submitted that the protections referred to at pages 34 – 40 of the Discussion Paper operate to ensure that there is a fully informed disinterested vote in circumstances where the equality of opportunity principle as embodied in the Chapter 6 regime would otherwise be infringed. The following passage from the judgment in *Re Ranger Minerals Ltd* [31]is instructive in this respect:

> *"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".*

Recommendation

Schemes of arrangement have been recognised as true alternatives to bids under Chapter 6 of the Act. In circumstances where the legislation provides for such a choice, and establishes sufficient protection for members and creditors the subject of a scheme, s411(17) of the Act should be repealed. The effect will be to minimise the uncertainty and completion risk that, at least in recent times, exists at a theoretical level, as in practice, the courts have read down s411(17)(a) and have been ready to accept reasons put forward by scheme proponents as to why a scheme has not been implemented to avoid the bid provisions in Chapter 6 of the Act.

It should be noted that if s411(17) is repealed, ASIC would still have a role to play in reviewing schemes in relation to matters specifically regulated by the scheme provisions or coming within the general exercise of the court's discretion under ss411(4) and 411(6). This would include issues of class composition, extrinsic interests, disclosure and fairness. ASIC would still be able to intervene at the court approval stage, pursuant to its general

[28] *Corporations Act*, s 621(3).

[29] *Re Hellenic & General Trust Ltd* [1975] 3 All ER 382 at 386; *Archaen Gold NL* (1997) 23 ACSR 143 at 148; ASIC Regulatory Guide 142.42, 142.46.

[30] *Re Ranger Minerals Ltd; Ex parte Ranger Minerals Ltd* (2002) 42 ACSR 582 at [32], [36] and [40]; *Anzon Australia Limited, in the matter of Anzon Australia Limited* [2008] FCA 309 at [13].

[31] (2002) 42 ACSR 582 at [45].

powers in s1330 of the Act. Similarly, any interested party could also make submissions to the court.

Ultimately, it is submitted that the key issue in relation to s411(17) is one of disclosure. In circumstances where:

(a) the scheme proponent is required to provide full and fair disclosure to members or creditors of all information material to their decision whether to approve the scheme;

(b) the scheme proponent is required bring to the attention of the court all matters that could be considered relevant to the exercise of the court's discretion;

(c) ASIC has a continuing role in relation to the review of scheme documentation;

(d) members or creditors are provided with a forum to debate the issues in an informed manner before voting on the scheme; and

(e) ASIC and/or any interested party has a right to make submissions to the court at the approval stage,

the acceptance schemes of arrangement as a true alternative to bids under Chapter 6 of the Act suggests that s411(17) of the Act no longer has a role to play in the regime under Chapter 5 of the Act.

Yours faithfully
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