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Dear John

Submissions in response to the CAMAC discussion paper on Members' Schemes of Arrangement (Discussion Paper)

On behalf of Minter Ellison I thank you for the opportunity to comment on the issues raised in the Discussion Paper. We have accepted the invitation on page iii of the Discussion Paper to raise matters related to members' schemes that may call for consideration. In this regard, some of our comments extend to creditors' scheme of arrangement; in our view these matters also relate to members' schemes and call for consideration because the distinction between creditors' schemes and members' scheme is, on examination, arbitrary and somewhat troublesome in practice.

Our response is divided into two parts - overall comments on schemes generally and comments on specific issues. Most of the specific issues are matters adverted to in the Discussion Paper. Where this is the case, a paragraph reference to the Discussion Paper is provided in the heading of the issue.

The general issues are discussed first followed by specific comments on matters adverted to in the Discussion Paper in the order raised in the Discussion Paper. Comments on issues not raised in the paper are included in section 7 of this response. We have highlighted our specific recommendations with boxing for ease of later reference.

1. Overall comments on schemes generally

It isn't broken; don't break it

1.1 Compared to the legislation governing takeover bids (**bids**), the legislation governing schemes has been a great success. The scheme provisions have been subject to much less amendment and do not require extensive ASIC relief to make them work - the only

modifications to the scheme provisions granted by ASIC relate to the detailed disclosure matters in Schedule 8. The legislation governing schemes has achieved a nice balance – it has been prescriptive enough that the courts have not felt the need to imply restrictions on the scheme process while still allowing schemes to be used in a very flexible fashion.

1.2 There are two specific dangers. First, making the scheme provisions too prescriptive and black letter (like the bid provisions) will limit the future usefulness of schemes and will likely necessitate the grant of an extensive relief regime to ASIC. Second, making the scheme provisions too general and broad ranging may lead the courts to imply restrictions on the jurisdiction granted to them.

It would be sensible to codify principles contained in decided cases

1.3 Over time the scheme provisions have been the subject of judicial interpretation and customary procedures.

1.4 It would be sensible to codify this learning to aid consistency of administration and the accessibility of the scheme provisions for those less familiar to them (which may assist both scheme litigants and judicial officers who have had limited exposure to schemes).

1.5 The obvious areas for codification include: the meaning and implications of classes (see section 4 below), the need for *Quistclose* trust arrangements[1] for payment of consideration, appropriate warranties and treatment of third party interests (see paragraphs 2.6 and 2.7 below) and the extent to which procedural matters need to be formally proved (see paragraphs 7.17 and 7.18 below).

1.6 Any codification effort needs to be undertaken carefully so that it does not constrain the flexibility of schemes (see our comments in paragraph 1.1 above). It may be that general principles can be set out in the regulations codifying these issues while still leaving the application of the principles to particular cases to the courts.

A general scheme mechanism

1.7 The distinction between creditors' schemes and members' scheme is arbitrary and somewhat troublesome in practice. It is, for example, difficult to support this distinction in the context of dealing with options. Option holders are plainly not members but it seems artificial to treat them as creditors. Equally, but perhaps less relevantly to the Discussion Paper, the term creditors may not be as wide as desirable – take, for example, potential future asbestos claimants and employees.

1.8 Similarly the fact that schemes are limited to Part 5.1 bodies can be awkward where business entities are structured as combinations of entities some of which are amenable to schemes and some of which are not. The obvious example of this is unit trusts stapled to companies. The work done in a reconstruction or 'scheme' takeover of the trust forming part of such a structure is often structured as a trust deed amendment and does not have

[1] *Quistclose* trust arrangements are not further discussed in this response. They are the arrangements, usually now adopted in a takeover by way of scheme, whereby the scheme consideration is paid into a trust account held by the scheme company for payment to scheme participants. The payment into the trust account is required to occur prior to the transfer of the securities held by the scheme participants.

the same force (or safeguards) as a scheme. Extending the scheme provisions to cover other business entities would seem to have many benefits and no downsides (beyond those in the existing scheme process).

1.9 Subject to the voting issue described in section 6.3 below and constitutional issues, we recommend that the scheme provisions be widened and deepened by:

(a) combining members' and creditors' schemes;

(b) widening the groups of interest holders to which schemes can apply to all types of interests holders (or potential interest holders) rather than just members and creditors; and

(c) expanding the jurisdiction of schemes to trusts and other types of business entities (including, in particular, limited partnerships).

2. Issues relating to Chapters 1 & 2 of the Discussion Paper – schemes generally

References to members should be retained [1.2.3]

2.1 While the Discussion Paper uses the term 'shareholders' rather than 'members', there is a need to continue to refer to the more general term 'members' in the statute in preference to 'shareholders' to ensure that non-shareholder entities continue to be covered (for example, to facilitate demutualisations). (We note that the 'simplification' of the financial assistance provisions in Part 2J.3 whereby reference is made to shareholder approval has cast doubt on the ability of, for example, members of companies limited by guarantee to financially assist the acquisition of shares in a parent.)

References to 'compromise' [1.3.2]

2.2 As noted in the Discussion Paper, the term 'arrangement' encompasses the term 'compromise' in the scheme provisions. It follows that the term 'compromise' is unnecessary and should be deleted.

Procedure for meetings [1.3.3]

2.3 Until the assertion, by Santow J at para (4) of App B in *Re NRMA Insurance Ltd (No 1)* (2000) 33 ACSR 595 at 649 (adopted by Barrett J in *Re Sims Group* (2005) 55 ACSR 422 at [9]), that the provisions of Part 2G.2 (the general meeting rules) apply to scheme meetings as well as general meetings, it was not clear that this was the case (other than by virtue of court rules). The mandatory application of these provisions is not necessarily helpful. There may, for example, be cases where it is appropriate to convene a scheme meeting on less than the required 21/28 days notice[2]. It is unclear why the courts should not have jurisdiction to authorise such a meeting in appropriate circumstances.

[2] See sections 249H and 249HA.

2.4 We recommend that the scheme provisions be amended to make it clear, in the legislation, that Part 2G.2, and the 'register snapshot provisions' in regulation 7.11.37 and following, apply to schemes, subject to a power in the court to order otherwise.

Section 414 [1.5.2]

2.5 The Discussion Paper invites submissions on whether section 414 still performs a useful purpose. In our view, any changes to section 414 should only be made after further and separate consultation on the various available compulsory acquisition mechanisms. Section 414 has no relevance to schemes and should not be dealt with together with them.

The bidder's title to securities under transfer schemes [2.2]

2.6 The issue of whether a bidder acquires securities subject to encumbrances under a transfer scheme is discussed in paragraph [24.071] of *Ford's Principles of Corporations Law*. It is submitted that the scheme provisions should allow the bidder to acquire the securities free of third party encumbrances in most circumstances. In particular, the bidder should not have to rely on the bona fide purchaser doctrine (which applies where a purchaser acquires the legal estate for value without notice). This is for two reasons. First, some bidders (because of their extensive or diverse operations) may not be able to easily determine if they have notice. Second, if the scheme provisions are extended to cover equitable interests (for example, units in a unit trust), the bona fide purchaser doctrine does not operate.

2.7 It is recommended that the scheme provisions be amended by providing that, subject to order of the court, the acquisition of interests in or issued by the entity proposing the scheme (**Transferred Property**), under or in accordance with the scheme, occur free from any third party encumbrances provided that the acquisition is made in the absence of an active intention to unfairly diminish the value of the rights of the third party. It should also be clear that, in such circumstances, the encumbrance attaches to the scheme consideration in the hands of the scheme participant. The intention is that, as a safety net, the holder of any encumbrance who considers that the extinguishment of its rights as against the Transferred Property is unreasonable would have an opportunity to argue that the scheme should not be approved at the second court hearing.

The interaction of the scheme provisions and other provisions in the Corporations Act *[2.3.2]*

2.8 There is clear authority that schemes cannot be used to do things for which express provision is made in the *Corporations Act* (See, for example, *ASC v Marlborough Gold Mines Limited* (1993) 10 ACSR 230). Often these other provisions will require approval at general meeting (as distinct from a scheme meeting).

2.9 Consistently with this position, a scheme cannot be used to alter a company's constitution but schemes can override or be inconsistent with a constitution (*Re Glendale Land Development Ltd (in liq)* [1982] 2 NSWLR 563).

2.10 To the extent that another provision in the law requires approval of members, there is no reason why such approval should not be obtained at the scheme meeting (rather than a separate general meeting) assuming that all relevant members can vote at the scheme

meeting. For example, in demergers it is common to have a scheme together with a capital return. There is no policy reason that the capital return should have to be voted on at a separate general meeting. Indeed, there is no policy reason why the scheme and capital resolution should have to be voted on separately (as they are part of an indivisible package), so long as the threshold for approval is the highest of the thresholds for all the component approvals. Additionally, it is anomalous that schemes can in effect rewrite a company's constitution but cannot record the changes by altering the constitution. The court should be given incidental powers, in appropriate circumstances, to order that the constitution of a company be altered when approving a scheme in respect of the company.

Registration of members' schemes [2.3.3]

2.11 Given that, under section 411(2)(b), the court cannot make an order convening a scheme meeting under section 411(1) or (1A) unless the court is satisfied that ASIC has had a reasonable opportunity to consider the explanatory statements for the scheme and make submissions on it, there is little point in requiring the subsequent registration of the document. As a practical matter, ASIC usually seems to adopt the view that an explanatory statement is in order for registration (see section 412(8)) if the court has made an order under section 411(1) or (1A). The only real effect of section 412(6) is to catch the unwary.

2.12 The registration requirement in section 412(6) for explanatory statements for members' schemes should be abolished as it serves no purpose in practice.

3. Issues relating to Chapter 3 of the Discussion Paper – disclosure issues

Incorporation by reference [3.1.1]

3.1 We can see no downside in allowing incorporation by reference in the context of schemes, although we expect that it will not often be used, except perhaps in relation to incorporation of information in financial statements.

The application of the clear concise and effective test to scheme disclosure documents [3.1.1]

3.2 The clear, concise and effective test should not be applied to scheme disclosure documents, because:

(a) the interaction of the test and the general disclosure standard would be unclear[3];

(b) market practice suggests that this test has not materially improved the quality of other disclosure documents**;**

[3] The current position with prospectus and PDSs is already unclear given the application to them of the clear, concise and effective standard (sections 715A and 1013C(3)). It is unreasonable for the statute to impose general disclosure obligations on the persons responsible for preparing such documents and impose criminal sanctions for failure to comply with the general disclosure obligations and yet insist that any disclosure be concise. If there is a desire to make disclosure documents (or scheme explanatory documents) shorter, it should be for the legislature to determine which material can or must be omitted. It logically follows that, having made such a decision, no possible liability (or other disadvantage) should fall on a person preparing a document because of the omission.

(c) there is adequate protection for investors through the pro-active pre-vetting that ASIC undertakes and the discipline created by the supervision of the Court; and

(d) the application of the test, if introduced in the context of schemes, may require evidence to be adduced in court that the standard has been satisfied. This is likely to require 'expert' opinion in relation to an inherently subjective and uncertain judgement. This would lead to increased transaction costs.

Supplementary disclosure [3.2]

3.3 We support the view that the scheme provisions should be amended to provide a regime for supplementary disclosure. Neither section 411 nor section 412 of the Act provide for the issue of a supplementary explanatory statement for a scheme. However, recent market examples illustrate that, in schemes used to effect friendly takeovers, new circumstances or material changes in circumstances often arise following the despatch of the explanatory booklet. This is typically the result of a competing proposal (often structured as a Chapter 6 takeover bid) being publicly announced in the period between despatch of the explanatory booklet and the scheme meeting.[4]

3.4 Assuming that:

(a) the first bidder elects to persevere with its scheme structure in the face of a subsequent competing Chapter 6 bid (as opposed to withdrawing its scheme proposal and switching to a Chapter 6 bid itself); and

(b) the scheme company (target) still supports the initial proposal structured as a scheme,

the scheme company will usually issue a supplementary explanatory statement and seek an adjournment of the scheme meeting. This supplementary explanatory statement will typically refer to the emergence of the competing proposal and explain the impact of this on the earlier recommendation of the directors in relation to the scheme.

3.5 Whether the scheme company needs to seek court permission in relation to the release of any supplementary disclosure is a matter that has been left to the courts to determine. The cases noted in paragraph [3.2] of the Discussion Paper reflect the absence of consistent, definitive guidance from the courts. The relevant principles were recently considered and

[4] See e.g. the subsequent Chapter 6 bids announced after the following scheme proposals were announced: the 2007 Consolidated Minerals/Pallinghurst Resources scheme, 2006 Citect/Schneider Electric scheme, the 2006 Vision Systems/Ventana Medical Systems scheme, the 2003 Hamilton Island/General Property Trust and Voyages Hotels & Resorts Scheme and the 2000 St Barbara Mines/Taipan Resources scheme. In all of these examples, except the Citect scheme, the initial bidder responded to the emergence of the rival bid by withdrawing its scheme proposal and switching to a Chapter 6 bid structure. In the Citect scheme, the initial bidder increased its offer price twice and maintained its scheme structure, in the face of a competing Chapter 6 bid that was publicly announced after the explanatory booklet for the scheme was dispatched to Citect's shareholders. However, this required Citect (as the notional "target company" and proponent of the scheme) to return to court for permission to increase the scheme consideration, as well as seeking orders adjourning the scheme meeting and approving a supplementary explanatory booklet that referred to the competing Chapter 6 bid. The initial bid structured as a scheme prevailed against the competing Chapter 6 bid for Citect, even though this involved a second adjournment of the scheme meeting and a second supplementary explanatory booklet, to take account of developments during the contest for control of Citect.

refined in *Re Symbion Health Limited* (No 1), (No 2), (No 3) & (No 4) [2007] VSC 571. The principles emerging from this series of cases may be summarised as follows:

(a) The duty to make further disclosure in response to a material development during the scheme notice period does not necessarily require the directors of the scheme company to apply to the court for approval of the proposed supplementary disclosure. However, where for example:

(i) the scheme company is the subject of a competing takeover bid and the rival bidder is challenging aspects of the scheme or the adequacy of the disclosure in the explanatory statement that has been despatched to shareholders; or

(ii) the scheme company is involved in a substantial dispute and the proposed supplementary disclosure is relevant to the matters in dispute; or

(iii) the proposed supplementary disclosure relates to a key condition or element of the scheme proposal,

it is prudent for the directors of the scheme company to apply to the court for directions authorising the release of the proposed supplementary disclosure.

(b) If directors decide to apply to the court for directions concerning the disclosure of supplementary information, the court is authorised to deal with the application as part of its supervisory jurisdiction in schemes of arrangement. It would not be appropriate for the court to express any subjective opinion on the commercial merits or otherwise of the proposed supplementary disclosure, just as no imprimatur is conferred on the scheme or the original explanatory statement when the court orders that a meeting be convened to consider the scheme. Directions for the despatch of supplementary material 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.

(c) Nevertheless, a court should not direct the despatch of supplementary disclosure material unless it is of the view that if those materials are despatched in a timely fashion and the scheme is approved at the relevant meeting or meetings, the court would approve the scheme on an unopposed application.

3.6 It is also relevant to note the recent case of *Re Uranium King Ltd (No 3)* [2008] FCA 1196 which deals with supplementary disclosure for matters arising after the scheme meeting but before the second court hearing. This is a relatively short period of time (usually approximately one week). However, as this recent case demonstrates, any supplementary disclosure regime would also need to cover this further period. In this case, a scheme of arrangement between U and its members had been approved by the requisite majorities at the scheme meeting. However, the court adjourned the hearing of the application to approve the scheme of arrangement, as the court was concerned that a material matter had arisen after the scheme meeting that ought properly be disclosed to members. The court's concern was that the Securities Exchange Commission in the US had informed U that it may have breached a provision of the Securities Exchange Act and that the new information was relevant to certain litigation in New Mexico. The court

considered that this new information may influence the members' decision whether to continue to support the scheme of arrangement and directed U to write to its members advising them of new information which had come into existence after the scheme meeting. In this way, members would have the opportunity to oppose the making of final orders after the disclosure of the new information.

3.7 U filed further evidence showing that it had complied with this direction and that no member of U had indicated any intention to oppose the making of final orders approving the scheme of arrangement. In considering whether to approve the scheme, the court considered whether all the procedural requirements had been complied with. The court noted U's conduct of despatching supplementary information to its members and concluded that each member had ample opportunity to oppose the making of final orders and accordingly approved the scheme of arrangement.

3.8 We support the inclusion of a statutory regime for supplementary disclosure similar to that in sections 643 and 644 for Chapter 6 bids and that codifies the key principles from the existing case law. However, the supplementary disclosure regime should not be overly prescriptive and, in recognition of the court's supervisory jurisdiction, should expressly reserve to the court a power to give directions on whether supplementary disclosure is required and to approve the release of any supplementary disclosure. The supplementary disclosure regime should also incorporate an obligation to file a draft of the proposed supplementary disclosure with ASIC at the same time as it is filed with the court so that ASIC is kept informed.

Standardisation of liability and disclosure defences [3.3]

3.9 For both a scheme effecting a takeover and a bid, target shareholders should receive all information material to a decision to vote in favour of the scheme or to accept the takeover bid. This is consistent with the members' needs philosophy that underpins both the prospectus disclosure provisions of the *Corporations Act* (see paragraph 3,034 of the Explanatory Memorandum to the *Corporations Bill 1988*), and the general law standard for the provision of information to members in the context of a meeting[5].

3.10 The current disclosure standards substantially capture this requirement (ss411(3) and 412(1)(a)(ii) in relation to schemes and s636(1)(m) in relation to bids). On the other hand, there are no disclosure defences for schemes and no specific liability regime.

3.11 We submit that an area where the scheme disclosure provisions should be aligned with those relevant to takeover disclosure documents is in relation to liability and defence provisions – sections 670A – 670F should be mirrored in the scheme provisions.

3.12 The choice of transaction structure should not be driven by the clarity and certainty of the liability and defence regime available to people involved in the preparation of transaction documents.

[5] Directors must disclose all information which it would be obvious to the average commercial reader they should have (*Buttonwood Nominees Pty Ltd v Sundowner* (1986) 10 ACLR 360 at 362) a well as make full disclosure of facts within their knowledge which are material to the decision before shareholders (*Bulfin v Beabarfield's Ltd* (1938) 38 SR (NSW) 424 at 440)

'Best interests of members' versus 'fair and reasonable' [3.4]

3.13 In the takeover context, the 'fair and reasonable' standard is convenient. Commonly interpreted to require a comparison of value against theoretical value and market value, the test is relatively easy to apply. It would be equally suited to schemes effecting takeovers. However, it would not necessarily be suitable for other types of schemes – see, for example, paragraph 38 and following of ASIC Regulatory Guide 111 (which deals with the expert's opinion for acquisitions of shares approved by shareholders).

3.14 The expert's opinion 'best interests of members' standard for schemes should remain different to the 'fair and reasonable' standard for bids given the wider scope for schemes, unless takeover schemes are dealt with separately from other schemes.

4. Issues relating to Chapter 4 of the Discussion Paper – classes and voting

Use of the term 'class' in the context of schemes [4.1]

4.1 The use of the term 'class' in the scheme context tends to obscure the actual intent of the provisions. We recommend that a different term be used in place of 'class'. For clarity, we will use the term 'voting constituency'.

4.2 Outside the scheme context, a class of members is determined by the rights attributable to the members. In the scheme context, voting constituencies are determined by the ability of the members to consult together with a view as to their common interest[6]. The use of the term class in the scheme context is unfortunate – it means that separate classes of members (that is, those with differing rights) are necessarily in differing voting constituencies as far as scheme approval is concerned whether or not the members can consult together with a view as to their common interest. This of course means that there are more voting constituencies than would appear necessary in a policy sense with a greater chance that a scheme can be vetoed by one of those voting constituencies when the scheme would have been approved if they had formed only one voting constituency.

4.3 An alternate solution to this issue would be to empower the court to merge classes into one voting constituency in appropriate circumstances.

Distinction between issues that are class determinative and issues that are relevant to assessment of fairness [4.1]

4.4 There is understandable confusion over the circumstances in which differing interests that result in members not being able to consult together with a view as to their common interest cause those members to be in different voting constituencies.

4.5 The position appears to be that it is only dissimilarity of interest as far as the effect of the scheme relevant to their capacity as members which will result in the members being in differing voting constituencies. Other types of interests may be relevant to the court's assessment of fairness at the second hearing but will not split the members into separate voting constituencies. For example, the fact that a substantial subgroup of members holds options while another subgroup does not will not result in the whole group of members

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

being split into two voting constituencies even if the overall position of the option holding subgroup is substantially different by virtue of them holding options. On the other hand, the court would presumably want to be satisfied at the second hearing, as a matter of fairness, that which ever subgroup is being less well treated also approved the terms of the scheme

4.6	We recommend that the principles which determine when separate voting constituencies exist be codified to the extent possible.

Determination of classes [4.1]

4.7	We support the view that the scheme provisions should be amended to give the court an express power at the first court hearing to make a binding determination on the composition of classes (or at least a power to conclusively determine that characteristics identified in the court's order do not give rise to multiple classes). The exercise of this power would remove execution risk for proponents of schemes. This is because, as the Discussion Paper notes, although the scheme company may seek directions from the court on the proper constitution of classes at the first hearing, any directions are not binding on the court at the second approval hearing. This gives objecting shareholders at that second hearing the capacity to oppose the approval of the scheme on the basis that the classes were incorrectly constituted.

4.8 Over the years, the courts have consistently articulated a number of specific principles regarding classes (see examples below). We consider that these principles are now well settled and would give a court confidence at the first court hearing to exercise a legislative power to make binding class determinations to that effect. For example, if the suggested statutory power to make binding determinations on classes at the first court hearing existed, we consider that a court would readily exercise that power to determine that:

- in a takeover scheme where the consideration is or includes scrip in the proposed acquirer and the scheme provides that shareholders with registered addresses in an overseas jurisdiction will receive the net cash proceeds of the sale of the scrip to which they would otherwise be entitled, these excluded or ineligible 'foreign shareholders' do not constitute a separate class: see e.g. *Re CSR Ltd* [2003] FCA 82; *Re Hills Motorway Ltd* (2002) 43 ACSR 101 a 104 and

- in a concurrent creditors' scheme involving the acquisition or cancellation of options issued by a target company, it is not necessary to create a separate class for optionholders who hold different series of options having different issue dates, exercise prices and expiry dates, provided all options are consistently valued using the Black Scholes valuation method: see *Re MIA Group Limited* [2004] 50 ACSR 29, referred to with approval in *Zenyth Therapeutics Ltd v Smith* [2006] VSC 436 at paras 50 to 53.

4.9 Conversely, the courts discretion to refuse to approve a scheme at the second court hearing on grounds of fairness would provide a safeguard against unfair class determinations at the first hearing in the absence of affected parties. In this regard, we do not support any proposal to give shareholders advance notice of the first court hearing. Doing so would likely delay the timetable for schemes and raise arguments about

hypothetical issues which would be either irrelevant or more readily dealt with at the second court hearing after voting outcomes are known.

Headcount test (companies limited by shares) [4.2.4]

4.10 We submit that the current headcount test be retained, as it compels the scheme proponent to consider the interests of smaller shareholders, not just the larger shareholders.

4.11 As the Discussion Paper has noted,[7] the amendment to section 411(4)(a)(ii)(A) which became effective on 31 December 2007 qualified the headcount test by giving the court power to '*order otherwise*'. The policy justifying this amendment is unclear.

4.12 On the one hand, the purpose of the amendment is described in the Explanatory Memorandum as giving the court a discretion to disregard a majority vote under the headcount test where there is evidence of share splitting. To the extent that the amendment addresses this concern, it clearly addresses a policy concern. However, the section is not constrained to share splitting and the legislation gives no assistance to the court in determining when it should disregard the headcount test and the factors which it ought take into account. It is difficult, *a priori*, to identify any circumstances beyond share splitting that would justify disregarding the headcount test (assuming that the headcount test is to be retained). If circumstances emerge later, a power vested in the court to dispense with the headcount test is unsatisfactory because the proposal will need to be fully developed and at least the first court hearing conducted before the question of an order being made is determined. This level of commercial uncertainty suggests that the power will not, practically speaking, be used except in extremis.

4.13 We recommend that the power to dispense with the headcount test be repealed and replaced with:

(a) exemptions under the regulations (which, in the first instance, would address the share splitting issue); and

(b) exemptions by ASIC instrument (to allow new issues to be addressed 'up-front' before the first court hearing).

4.14 The exemption by regulation power would also potentially assist with the other major problem with using the current power to address share splitting – identification of the evidence needed and relevant burdens of proof.

4.15 We oppose the introduction of a '*super-majority*' requirement (say, 90%) of the shares voted on the resolution, which is one of the options in the Discussion Paper[8]. Given the available evidence of member voting patterns in schemes[9], such a '*super-majority*' requirement would represent a very high effective approval percentage and one for which history provides no justification – there has been no suggestion to date that the 75% of shares voted test has given rise to mischief.

[7] At pages 53 and 57 of Discussion Paper
[8] At page 61 of Discussion Paper
[9] Paragraph [4.2.3] of Discussion Paper

4.16	We also oppose introduction of a participation threshold as described in the Discussion Paper[10] for the reason identified in the Discussion Paper[11], namely, that it would remove one of the main advantages of schemes, that they cannot be defeated through the non-participation of apathetic or other uninvolved shareholders. The court's discretion to approve is a more flexible and no less effective mechanism.

Headcount test - companies limited by guarantee [4.2.5]

4.17	We submit that there should be no change to the current requirements that a members' scheme for a company limited by guarantee only require the approval of a simple majority of members voting on the scheme under the headcount test.

4.18 The interests of members of a company limited by guarantee are normally fundamentally different to those in a company with a share capital in that there is no degree of membership or degree of interest. The 75% of shares voted test means that, in most circumstances, the vast bulk of the economic interests in a company with a share capital is in favour of a scheme. Persons with an inconsequential interest in the company could not block a scheme, at present, unless they represent more than 50% of the members voting. In the case of a company limited by guarantee, it is impossible to find an equivalent of a 'shares voted' indication of approval, but the same policy otherwise applies - persons with an inconsequential interest in the company should not be able to block a scheme unless they represent more than 50% of the members voting.

4.19 To the extent that there may be a view, in some cases, that mere 50% member approval for a scheme is not sufficient to justify approval of the scheme by the court, that is a matter that should be left to the court when it is deciding whether to approve the scheme because the court will be best placed to consider all the circumstances.

4.20 Further, as the Discussion Paper notes,[12] if the scheme involves matters requiring a special resolution, such as an amendment to the company's constitution, approval by a 75% majority of members who vote is required for that special resolution.

5. Issues relating to Chapter 5 of the Discussion Paper – the involvement of ASIC in schemes

ASIC exemption and modification powers [5.1]

5.1	We submit that ASIC's exemption and modification powers in relation to schemes be continued in relation to matters of disclosure and expanded to cover scheme disclosure matters generally (rather than just Schedule 8 matters) and extended to an exemption power in respect of the headcount test as discussed in paragraph 4.13. We agree with the view that, in contrast with the detailed and complex takeover provisions, the scheme procedural provisions are not of the same level of complexity and do not require ASIC to have equivalent general exemption and modification powers.

[10] At page 61 of Discussion Paper
[11] At page 62 of Discussion Paper
[12] At page 62 of Discussion Paper

5.2 We submit that any appeal from ASIC's exercise of those powers should not be to the Administrative Appeals Tribunal or to the Takeovers Panel, but specifically directed to a court which otherwise has jurisdiction to hear scheme applications. It would be unwieldy and unnecessarily expensive if an appeal from ASIC's exercise of general exemption and modification powers for scheme provisions had to be made to the Administrative Appeals Tribunal or to the Takeovers Panel, but the scheme applications for the convening of a scheme meeting and the approval of such a scheme then had to be separately made to a court. It is highly desirable that both aspects of such a transaction be determined before one body, and that should be a court.

5.3 In many State Supreme Courts and the Federal Court of Australia, applications made under section 411 are heard before designated Corporations List judges and such judges would clearly have the expertise to determine any appeals from an exercise by ASIC of such general exemption and modification powers it might be given for schemes.

Section 411(17) [5.2.2]

5.4 We support the view that both sub-sections 411(17)(a) and (b) should be abolished. As noted in the Discussion Paper[13] the courts have over many years recognised that a scheme of arrangement is a legitimate alternative to a bid under chapter 6 of the *Corporations Act*. Similarly, the current ASIC Regulatory Guide 60 states that 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 any other type of acquisition…*'. If those protections are equivalent, there is no policy reason to favour any particular method by which an acquisition is made.[14]

5.5 Although the current state of the authorities indicates that where ASIC provides a 'no objection' letter to the scheme proponent under sub-section 411(17)(b) the court is not required to undertake a consideration of the purpose of the scheme of arrangement under section 411(17)(a)[15], the presence of section 411(17)(a) seems to trouble the court periodically (see for example *Mincom Limited v EAM Software Finance Pty Ltd* (2007) 61 ACSR 266 and *Re Coles Group Limited (No 2)* (2007) 25 ACLC 1,876). No doubt this judicial concern is generated, to a certain extent, by the bellicose language of section 411(17)(a) which, if it were to apply, would require a scheme proponent to prove a negative proposition.

5.6 In our view, section 411(17) serves no useful purpose and therefore it ought to be abolished. On the other hand, if it can be clearly established that section 411(17) has an oblique policy justification, section 411(17) should still be abolished and that policy should be clearly expressed in the legislation.

5.7 Another reason to abolish section 411(17) is to prevent misuse of the section by ASIC. ASIC from time to time adopts the position that a scheme proponent must either agree to accommodate changes raised by ASIC during the statutory review period (unconcerned with the issues in section 411(17)(a)) or accept the fact that ASIC would not be minded to grant a section 411(17)(b) letter. As proceeding without a section 411(17)(b) letter is

[13] Paragraph [5.2.1]
[14] ASIC Regulatory Guide 60, paragraph 60.7
[15] *Macquarie Private Capital A Limited* [2008] NSWSC 323 at [27]

regarded as introducing considerable uncertainty into whether a scheme will be approved, this colourable use of section 411(17) effectively gives ASIC a veto over scheme terms. It is submitted that the proper course would be for ASIC to raise any concerns it has with particular scheme terms first with the scheme proponent and then the court rather than exercising an effective veto by an *in terrorem* threat of putting the scheme proponent to proof of the issues in section 411(17)(a) when those issues are not otherwise relevant.

The role of ASIC [5.2.3 & 5.2.4]

5.8 By supporting the abolition of sub-section 411(17)(b), we do not propose that ASIC's role be limited to that of reviewing the draft explanatory statement under sub-section 411(3). ASIC should continue to have a close involvement in schemes, to avoid the current unfortunate position in proceedings before the Takeovers Panel, where ASIC largely leaves regulation of takeovers to the Takeovers Panel without ASIC policy input.

5.9 We agree that there should be a fresh consideration of what assistance ASIC should be required by the Act to provide to the court, but always leaving the court as the final arbiter of any issues which ASIC might draw to the court's attention. At the least ASIC should be required to address the court on any issues raised by the court. In addition, our view is that ASIC should be required to address the court, or explain to the court why it is unnecessary or inappropriate for ASIC to do so, at the request of the scheme proponent or any other party to the scheme proceedings. This is not intended to affect the obligation of a scheme proponent to draw the court's attention to all relevant matters on an application.

5.10 Assuming that ASIC continues to have a policy role in reviewing schemes, it would largely eliminate any need for an express provision in the Act applying the Eggleston principles to schemes of arrangement, as is described at paragraph [5.2.4] of the Discussion Paper. This would also allow the minimum bid price rule and other takeover concepts to continue to apply to schemes in a flexible manner as a matter of ASIC policy.

6. Issues relating to Chapter 6 of the Discussion Paper – extension of schemes

Option and convertible note holders [6.1]

6.1 It is artificial to treat option holders and others with rights to shares as contingent creditors because, in the usual course, one would never expect an option holder to become a creditor. Rather, one would expect the option contract to be performed. (Similar comments apply to employees and most contractual counterparties.) It is even more artificial to treat option holders as contingent members in that they are clearly not members until the option is exercised.

6.2 As noted in paragraph 1.9 above, we favour widening the scheme mechanism to cover all types of interests (including contractual counterparties), but even if this suggestion is not adopted, it would be useful to amend the definition of 'creditor' so that it clearly encompasses contractual counterparties (where no default exists) and other doubtful cases.

6.3 The suggestion of a combined general scheme mechanism would raise the issue of which classes of interest need to be consulted before an arrangement can be approved by the court and given effect. In our view, it is only the holders of interests:

(a) whose rights are actually being varied; or

(b) whose rights are *unfairly* affected,

that should be consulted. In this regard, holders of options would not normally be consulted in relation to an arrangement affecting members because, even if their interests are affected by the scheme, their interests would not normally be *unfairly* affected if they merely suffer the consequence that the securities they are ultimately entitled to are affected in the same way as the securities presently held by members.

6.4 This corresponds to the situation which presently applies to option holders – a members' scheme will affect their rights, but, as they are not members, they will not be consulted as to whether the scheme is approved. However, if their interests are unfairly affected, they could seek to be heard at the second court hearing and object to approval of the scheme

6.5 If treated as creditors, holders of options will vote in accordance with the value of the options. One would normally expect that the value of the options can be determined by a Black & Scholes valuation of the options. However, this may be unsatisfactory for a number of reasons, including:

(a) the options may be subject to vesting or exercise conditions where it is either difficult to quantify their effect on value or that render the options effectively valueless to a third party; and

(b) the consideration offered for the options under the scheme may exceed the theoretical value of the options (for example, to give option holders an incentive to attend and vote to approve the scheme).

6.6 In these circumstances, votes will need to be determined on a basis other than strict value. The legislation should address this. However, as the Discussion Paper addresses members' schemes rather than creditors schemes, it would not now be appropriate to present an extended submission on the appropriate way to award voting rights in a creditors scheme.

6.7 As far as the application of the headcount test to votes by holders of options and convertible notes is concerned, our view is that the same issues as discussed in relation to votes of members in paragraphs 4.10 to 4.14 above are relevant.

Extension of members' schemes to listed and unlisted managed schemes. [6.2.1 & 6.2.2]

6.8 Consistently with our suggestion in paragraph 1.9 above that the scheme mechanism be extended to cover all types of interests, we support the extension of members' scheme to listed and unlisted managed schemes.

6.9 There is no policy reason not to so extend members schemes and it is clear that the extension would be useful at least in the case of listed managed schemes (particularly in relation to stapled entities.)

Mergers within corporate groups [6.3]

6.10 In our view, the "short-form merger procedure" within wholly-owned corporate groups, as recommended in the Advisory Committee report *Corporate Groups*, has considerable merit. The proposal is similar in its terms to the current procedure for the confirmation of schemes for the transfer or amalgamation of insurance businesses under both the *Life Insurance Act 1995* and the *Insurance Act 1973*, although the shareholders of the relevant companies similarly do not require protection, the relevant group to consider is the policyholders, not the creditors.

6.11 Prior to the commencement of Division 3A of Part 111 of the *Insurance Act* in 2002 (the corresponding legislative process has been available to life insurance companies since 1946 under the then *Life Insurance Act 1945*), the least complicated approach for companies wishing to transfer general insurance liabilities was pursuant to a scheme under the *Corporations Act 2001* or its predecessors. However, that method posed considerable difficulties. While the effectiveness of such a scheme was not dependent on the consent of every policyholder, a meeting of policyholders, or classes of policyholders, was required to be held, and the approval of a majority in number of those attending, and the approval of the policyholders representing at least 75% of the insurance company's potential liability to those attending, was required. In practice, this rarely happened.

6.12 While an application for confirmation of an insurance scheme requires careful consideration of a variety of issues and meticulous preparation, the simplicity and effectiveness of the scheme provisions under both insurance Acts have seen them much utilised. Unlike the *Corporations Act* scheme provisions, they do not provide for the policyholders impacted by the transfer or amalgamation to meet to consider the proposal. Accordingly, they do not operate on the premise that a sufficient majority vote of creditors is a jurisdictional requirement for the court approving the scheme: the court alone makes the decision. The key features of an application are that:

- actuaries appointed by the parties prepare a report expressing the view that the transfer will not materially adversely affect the interests of the transferor and transferee policyholders (cf the suggested certificate to be provided by directors);

- notice of the proposed transfer is given to all "affected policyholders", along with a summary of the scheme approved by APRA, a notice of intention to make the application must be published in the *Government Gazette* and newspapers in each State or Territory where policyholders reside and all policyholders are given the opportunity to inspect the scheme and the actuarial report, and to make submissions to the Federal Court of Australia at the hearing for confirmation (cf the suggested notice to be given to creditors); and

- after reviewing the actuarial report and hearing submissions from any policyholders who attend the hearing, the court has a discretion to confirm the

scheme without modification, confirm subject to modification or refuse to confirm (cf the proposed powers to be given to the court).

6.13 As the court's primary concern in respect of insurance schemes is to ensure that the interests of policyholders are protected, the policyholders do not suffer any prejudice because there is no provision for them to convene to consider the scheme. Similarly, as the procedure proposed for mergers within corporate groups contemplates the inviting of applications by creditors to the court, creditors should not have any cause for concern because of the simplified regime.

Schemes opposed by the company [6.4]

6.14 In practice, a members' scheme of arrangement requires the company the subject of the reconstruction proposal to assume responsibility for developing that proposal and submitting it to its shareholders (or one or more classes of its shareholders) for their consideration. This is a corollary of the fact that a members' scheme is a legal mechanism by which a binding arrangement may be entered into between *a company and its shareholders* to reorganise the capital structure of the company.

6.15 We believe that the scheme provisions should not be adapted to facilitate their use where a target board opposes a scheme. Our reservations fall into three categories.

6.16 First, in the absence of board approval there is an inequality of bargaining power in that there is no one to represent the interests of the members. It is plainly impossible in practical terms for the members-in-meeting to review, negotiate or even seek advice on the terms of the scheme. All the members can do is make a single 'yes' or 'no' decision. There is no, and can be no, equivalent of the individual decision making involved in a bid. To put it another way: to get to compulsory buy out under a bid requires acceptances from individuals holding at least 90% of shares; to get to compulsory buy out under a scheme requires only a single vote and normally a vote in favour by only 75% of shares voted. In the absence of the board, there is no unified collective decision. Apathy, perhaps fostered by confusion as to why the proposal is being brought to members despite the opposition of the board, will probably tend to work in favour of the hostile bidder. In the absence of the support of the board, there is a significant likelihood that the scheme proposed is not in the interests of members as a whole (even if approved in the absence of a better offer).

6.17 Secondly, we do not consider that there is either a need or policy justification for this proposal. Members schemes may be broadly divided into two categories:

- **Schemes to effect an internal reconstruction** e.g. to simplify a company's capital structure, to effect a demerger, to create a stapled security structure or to relocate the company's primary listing from one securities exchange (e.g.) ASX to an overseas securities exchange (so called 'redomicile schemes') – in relation to this first category of members' schemes, the reconstruction proposal would ordinarily emanate from the scheme company's board. Presumably, there would be limited interest in an existing shareholder or other proponent wanting to be able to use the scheme route to compel the company to propose an internal reconstruction scheme of the type referred to above. Even if such interest existed, a decision to undertake an internal reconstruction of the type referred to above is properly a matter for the directors of the company to assess,

discharging their statutory and fiduciary duties. This power should not be able to be usurped by or diverted to extraneous interests who could compel the company to propose an internal reconstruction scheme that does not have the support of the company's directors.

- **Schemes to effect a takeover** – in relation to this second category of members' schemes, there would appear to be little regulatory or policy merit in amending the scheme provisions to allow schemes to be used where the takeover proposal is opposed by the company's board. In these circumstances, the alternative of a Chapter 6 takeover is open to the proposed acquirer. If a proposed acquirer desires the certainty of the *all or nothing outcome* that a scheme offers, they are free to include a 90% minimum acceptance condition in their hostile bid.

6.18 Finally, a number of practical and logistical difficulties would need to be overcome to accommodate the use of schemes in circumstances where the proposal does not have the support of the scheme company. Significant amendment to the civil procedure rules of the relevant court and the legislation would be required. For example, the court rules regulating the originating motion and affidavits sworn in support of a scheme would need to be substantially amended to provide for these to be filed and sworn not by officers of the scheme company but by officers of the 'hostile' promoter of the scheme. Similarly, the legislation would need to be amended to fill the gaps that are currently addressed by implementation agreements. Many schemes involve third parties i.e. a party other than the scheme company and its shareholders. For example, in a scheme used to effect a friendly takeover, the third party is the proposed acquirer. The third party's involvement and obligations in connection with the scheme are regulated through an implementation agreement and deed poll, as Part 5.1 has no capacity for a scheme to bind anyone other than the company and its shareholders. Therefore, the implementation agreement (and deed poll) serves the important function of contractually binding the third party to perform its intended obligations to give effect to the scheme; e.g. in a scheme used to effect a friendly takeover, the implementation agreement imposes a contractual obligation on the proposed acquirer to provide the scheme consideration and to provide its input in drafting certain sections of the scheme booklet, such as funding arrangements (where the scheme consideration is or includes cash) and/or a detailed profile of bidder and its securities (where the scheme consideration is or includes scrip), as well as description of the bidder's future intentions with respect to the assets, employees and business of the target if the scheme is approved and implemented.

6.19 If the scheme provisions were allowed to be used where the board of the scheme company does not support the proposal, a situation would arise where the company is 'forced' by operation of law to convene a scheme meeting and issue an explanatory statement. Given the absence of the scheme company's recommendation of the proposal, there would be no implementation agreement with the promoter of the scheme proposal. Therefore, to enable the 'reluctant' scheme company to issue a meaningful and compliant explanatory statement, the legislation would presumably need to direct either the scheme company or the bidder to include in the explanatory statement the matters that would ordinarily be covered by mutual agreement in an implementation agreement. Given the diversity of schemes, legislating for this would be impracticable. Alternatively, the legislation would need to provide for the scheme company to work with the hostile proponent to obtain its

input as described above and otherwise work with the hostile proponent to settle the explanatory statement. Clearly, this would raise practical difficulties.

6.20 It seems inevitable that the discussion in the first court hearing about the content of the explanatory statement would become a new battlefield of tit-for-tat misleading and deceptive statement claims reminiscent of the in court takeover battles before the introduction of section 659B (which prohibits most court proceedings during the bid period).

7. Miscellaneous issues not responding to the Discussion Paper

Third parties should be allowed to become scheme parties if they agree to be bound

7.1 As the law presently stands, schemes bind only the scheme company and its members (or creditors). Often the arrangements proposed involved third parties who logically ought to be bound by the arrangements (either in favour of the scheme company or members/creditors directly). To get around this current shortcoming in the law, the current approach is to have a scheme implementation agreement between the scheme company and the third party and a deed poll by the third party in favour of members/creditors. This current approach, although well settled, continues to attract considerable judicial commentary regarding the imperative of mitigating performance risk for scheme participants.

7.2 The current approach is clumsy; often schemes are drafted as if the third party was bound by them when in fact it is not. The current approach may also deprive members/creditors of equitable remedies for breach of the scheme arrangements by the third party – as the members/creditors rights are primarily derived from the deed poll they may give no direct consideration to the third party and be left with only a claim for damages.

7.3 In our view, the scheme provisions ought to permit third parties to be bound to the company and the members/creditors under the scheme by order of the court with the consent of the third parties.

There is no need for the concept of 'schemes for reconstruction or amalgamation' in section 413

7.4 The court is empowered by section 413 to make a number of orders such as orders for the 'transfer' of assets or liabilities of a scheme company which are typically used in reconstructions or amalgamations. It is not clear why these powers should be confined to 'schemes for reconstruction or amalgamation' and where assets or liabilities are to be 'transferred' to a company. The powers would seem to be potentially useful in more general schemes and there should be no restriction on the nature of the 'transferee' provided that it submits to the jurisdiction of the courts.

7.5 We recommend that section 413 be amended by:

(a) deleting the reference to 'schemes for reconstruction or amalgamation' and making the orders available under section 413 available under schemes generally; and

(b) allowing any entity to be a 'transferee' under the orders provided that the transferee submits to the jurisdiction of the court.

Extension of section 413 to facilitate transfers of businesses

7.6 There are some circumstances where a simple order 'transferring' the assets and liabilities of one body to another may not be sufficient to place the 'transferee' in the same position as the transferor.

7.7 One example is where the benefit of a guarantee or indemnity (including policy of insurance) relates to liabilities of the 'transferor'. On the basis of *Housing Guarantee Fund Limited v Yusef* [1991] 2 VR 17 (referred to in *Stork ICM Australia Pty Limited v Stork Food Systems Australasia Pty Limited* (2007) 25 ACLC 208; [2006] FCA 1849), it appears that a transfer would not make the guarantee or indemnity relate to the liabilities of the transferee (at least those arising after the transfer). While this may in some circumstances result in a fair outcome, it seems an inappropriate limitation on the usefulness of section 413 to the transfer of businesses.

7.8 We recommend that section 413 be amended to give the court power to make such ancillary orders as it thinks fit in order to place the transferee entity in a position corresponding to that of the transferor entity as far as the assets and liabilities transferred are concerned, provided that such order does not cause substantial injustice to any third party.

Extension of section 413 to mergers and demergers

7.9 A number of foreign jurisdictions allow bodies corporate to be combined or subdivided without transfer in ways which Australian law does not contemplate.

7.10 We recommend that section 413 be amended to give the court power to make orders allowing for multiple entities to be merged or a single entity subdivided (without any transfer to a 'new' entity) and that the court be given power to deal with succession issues (including, in the case of a subdivision, which of the resulting entities is regarded as the pre-existing company for the purposes of specific documents).

Sections 200B and 200C

7.11 Both sections 200B (retirement benefits to board or managerial officers) and 200C (benefits to board or managerial officers in relation to transfers of a company's undertaking or property) have proved difficult in relation to demergers.

7.12 On one view, any demerger involving the transfer of shares in a subsidiary to members will breach section 200C if any board or managerial person (or connected persons referred to in section 200C) is a member of the company because the shares given as part of the demerger would arguably be benefits and they are also clearly property of the company.

7.13 Section 200B can also be problematic. For example, if a board or managerial officer becomes a board or managerial officer of the child entity being demerged, the person may well have retired as a board or managerial officer of the parent. If any benefit is received by the person in connection with the demerger, there may be a section 200B issue.

7.14 On the one hand, it would be possible to seek shareholder approval for the purposes of section 200B and 200C. However, this will be awkward. First, shareholder approval must be sought at a general meeting (as distinct from a scheme meeting) which would necessitate the holding of a general meeting if one is not otherwise required. Second, it can be difficult to explain the need for specific shareholder approval under section 200E if the benefits received are the same as those received by every other shareholder.

7.15 In our view, CAMAC should undertake a thorough review of section 200B and 200C. In the interim, both sections should be amended to exempt benefits given under schemes of arrangement where the benefits are equivalent to those given to other shareholders. (See also section 215 in the context of related party benefits.)

The wording of regulation 8303

7.16 The wording of regulation 8303 (which relates to the need for an expert's report) should be corrected so that it does not refer to 'the other party to the proposed reconstruction or amalgamation'. (Unless the recommendation at paragraph 7.3 is adopted, a bidder is not a party to a scheme – the only parties are the scheme company and its members.)

Rebuttable presumptions as to procedural matters

7.17 Over time, the courts requirements as to proof of procedural matters for schemes change to cover matters that might have been assumed previously. A recent example is the need for evidence that the copy of the scheme presented to the court is the same as that presented to ASIC for its examination in relation to section 411(2). In our view, the result of these changes has been to require a considerable amount of paperwork which does not benefit anyone (other than paper manufacturers).

7.18 In our view, it would be useful for the regulations or court rules to contain a list of the procedural matters that the scheme proponent is required to prove and a rebuttable presumption that all other procedural matters have been satisfactorily addressed.

Please feel free to contact me if you would like us to elaborate on specific points.

Yours faithfully
MINTER ELLISON

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