Alan Cameron AM

Members' schemes of arrangement play an increasingly important role in our marketplace. I welcome the attention being paid by the Committee to this topic, but will limit myself to the one issue of which I have personal experience and on which I hold a firm view

In relation to Section 3.3 of the discussion paper *Liability and defences for disclosure breaches*, Damian and Rich are clearly right that it is anomalous that the due diligence defences are not available. They should be, especially since those responsible for the statements are frequently not the commercial movers of the transaction. Directors of the scheme company are responsible not only for our own disclosures, but for the material being put forward by the promoter of the scheme, who would otherwise have been the bidder under a takeover. That is not sensible

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24 September 2008

Mr J Kluver
Corporations and Markets Advisory Committee
GPO Box 3967
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Dear Mr Kluver

In June the Corporations and Markets Advisory Committee issued a discussion paper on members' Schemes of Arrangement inviting submissions on any aspect of the Members' Schemes of Arrangement that may be of concern.

Australian Foundation Investment Company is Australia's largest investment company. It has a total investment portfolio of approximately $5 billion invested in close on 100 companies. The company has over 85,000 public shareholders who are mostly domestic retail shareholders. The Company has been in operation since 1928 and as an investor itself has had significant involvement over the 80 years in all manner of takeovers, reconstructions and similar company events.

Under the current Corporations Law, Chapter 6 sets out the various mechanisms by which one company can takeover another. From an investor's point of view one of the key safeguards of the processes provided in Chapter 6 is that for an offeror to compulsorily acquire shares from dissenting shareholders they must hold more than 90% of the securities in the bid class and acceptances from at least 75% of the securities that the bidder offered to acquire under the bid. We regard this mechanism as a significant safeguard to investors who wish to recognise the long term worth of their investment without having them too easily expropriated.

We have noted in recent years a significant trend for offerors to use Schemes of Arrangement as an alternative way of achieving a full takeover of a target company. In many cases these Schemes only offer cash as consideration. The threshold for a Scheme to be approved is for only a simple majority of shareholders at the meeting voting in favour of the Scheme and 75% of the votes cast at the meeting being cast in favour of the Scheme. Then all shareholders are committed to the Scheme and dissenting shareholders have their interest in the company compulsorily acquired. This is a significantly easier route for acquirers to move to full ownership of a target company.

One argument made by proponents of Schemes of Arrangement is that the Target Board needs to approve the Scheme Meeting for it to go forward. In our view few Boards dare take a robust approach and reject Schemes because of the risk of litigation and the fear that in the absence of a Scheme the target share price may fall.

The result of all this is that the threshold for compulsory acquisition that was originally provided in the takeovers provisions of the Corporations Law has now been circumvented by the use of Schemes of Arrangements and a considerably lower threshold now applies. In our view this means that the outcome is substantially tilted in favour of offerers at the expense of long term shareholders. We do not believe that it was the intention of the framers of the Corporations Law that Schemes of Arrangement should be used to circumvent the takeovers regime, rather they were originally provided to give shareholders a vote on reconstructions and similar complex corporate changes.

We would strongly urge the Committee to consider recommending a change to the law so that Schemes of Arrangement are not used in lieu of the takeover schemes or alternatively that the threshold for schemes of arrangement and the threshold for compulsory acquisition should be made equivalent and sufficiently high to protect the interests of long term shareholders.

This is a matter of great concern to us as an investor. We would be very happy to expand on these comments if that would be of further assistance.

Yours sincerely

Ross Barker
Managing Director

Submission to the Corporations and Markets Advisory Committee in response to its Discussion Paper on Members' Schemes of Arrangement

Introduction

1. Allens Arthur Robinson is pleased to provide this submission to the Corporations and Markets Advisory Committee (***CAMAC***) in response to its Discussion Paper of June 2008 on Members' Schemes of Arrangement.
2. The key observation that underlies the majority of AAR's submission is that the scheme of arrangement procedure is generally working appropriately and effectively as a mechanism for the implementation of a control transaction. In our experience, there is a general acceptance within the business and legal communities that schemes are a legitimate alternative mechanism to Chapter 6 takeovers for this purpose. There are also strong economic policy reasons for maintaining the ability to undertake a control transaction by way of scheme, as schemes are of fundamental importance to maintaining an open and effective market for control of Australian listed entities. Accordingly, while AAR sees some scope for reform of the scheme provisions, we consider that those reforms should largely be 'tidy ups'. We see no reason for wholesale or 'revolutionary' reform.
3. Further, we do not see any need for schemes to try to replicate the features or principles of Chapter 6 (or vice versa, for that matter). A scheme is a fundamentally different process than a takeover bid under Chapter 6, and it is not appropriate to try to craft provisions designed for the takeover bid process onto that for a scheme. The scheme process already has built into it all of the protections for shareholders in Chapter 6, and more, through the Court's supervision of the scheme, including its involvement in approving the composition of classes voting on the scheme and its ultimate discretion whether or not to approve the scheme at the second Court hearing.
4. If there is one particular issue that does need to be addressed in the scheme provisions, it is section 411(17) of the Corporations Act. Schemes and takeovers should be seen as two different but alternative mechanisms for effecting a control transaction, and our law should not try to promote or prefer one at the expense of the other. The market is at this point now, and it is necessary to remove section 411(17) to reflect this.

Information to shareholders (CAMAC Paper, section 3)

Effective disclosure (CAMAC Paper, section 3.1)

Introduction of a 'clear, concise and effective' disclosure requirement

5. AAR supports the introduction of a 'clear, concise and effective' disclosure requirement. This would provide a statutory basis for reducing the incentive for scheme companies to

provide excess disclosure for the sole purpose of minimising liability (reforming the liability regime as discussed below will also assist in this regard). It would also achieve consistency in treatment with the regimes applying to other disclosure documents.

Incorporation by reference

6. AAR supports the introduction of a statutory mechanism for information to be incorporated into scheme disclosure materials by reference. We consider that this would be entirely consistent with, and would promote the objective of, clear, concise and (most importantly) effective disclosure.

7. We also consider that the effectiveness of disclosure for schemes would be enhanced if particularly detailed or complex information (such as detailed financial or technical information, summaries of transaction documents or material agreements and copies of independent expert's reports and related technical expert's reports) was to be made available separately as optional disclosure for those shareholders who wish to see it (for example, via the internet or ASIC).

Reform of disclosure requirements

8. AAR supports the reform of the prescriptive disclosure requirements for schemes so as to:

   (a) omit the requirements currently in Part 3 of Schedule 8 to disclose information which is arguably irrelevant or covered by general disclosure requirements (ie, all known information that is material to the decision by shareholders);and

   (b) specify precisely which Chapter 6D or Chapter 7 disclosure requirements (and related principles) should apply where the scheme consideration includes scrip (whether in the form of shares, other financial products or otherwise).

9. We recognise that some of the provisions of section 636 might need to be repeated in the scheme disclosure provisions, while recognising that not all of those provisions will be applicable to control schemes and that there will be many schemes that are not arranged to effect a control transaction.

Supplementary disclosure (CAMAC Paper, section 3.2)

10. We consider that there is no need to introduce a supplementary disclosure regime. The current process and legal requirements for providing supplementary information in schemes (ie, seeking Court approval and providing a period of notice which is reasonable in the circumstances) work appropriately and effectively.

11. It is not appropriate to try to craft a takeover bid supplementary disclosure regime onto a shareholder approval process where there is a body of law governing whether supplementary disclosure is necessary in order for the vote at the meeting to constitute an informed consent, and the fact that a scheme is a Court supervised process and the Court will have its own view as to what supplementary disclosure is required, and when. However, as there may be circumstances in which it will be appropriate for the Court to make orders in relation to whether supplementary disclosure is required and the manner in which that disclosure is to be made, we consider that an amendment to the legislation to provide that the Court may order that supplementary disclosure materials need not be despatched to members (but may be made available to members by other means, such as

through ASX announcements or through the scheme company's website, thus minimising costs for the parties and avoiding delays or timing issues associated with physical despatch) may be desirable. Such an amendment would provide the Court with a statutory basis for making such orders.

12. The current process and legal requirements relating to supplementary disclosure may mean that a scheme is arguably less flexible than a Chapter 6 takeover. In our view, this is no reason of itself to amend the scheme provisions – rather, this should be seen as a consequence of the different protections for shareholders that are afforded under a scheme as compared with a takeover bid (in particular, the fact that schemes are supervised by the Courts whereas takeovers are not). Proponents of control transactions can take this into account when selecting the mechanism by which they wish to proceed.

Liability and defences (CAMAC Paper, section 3.3)

13. AAR supports there being a specific liability regime for scheme disclosure similar to the regime for bids under section 631 (or, where relevant, the regime in Part 6D where scrip is offered to members of the scheme company under the scheme), and that this regime should operate to the exclusion of all other liability regimes (such as section 1041H of the Corporations Act, section 12DA of the ASIC Act and section 52 of the Trade Practices Act).

14. Further, AAR considers that the underlying objective in the legislation should be for there to be one overall liability regime that covers all disclosure documents and explanatory materials produced by companies – that is, not only bid and scheme documents but also explanatory materials provided to shareholders for transactions such as buy-backs, capital reductions, section 611 item 7 proposals and other proposals - and one regime of defences (including a general due diligence defence). This could be supplemented by certain specific liability provisions where appropriate (for example, the regime in section 729 that makes certain persons in addition to a company and its directors liable for prospectus disclosure).

15. AAR supports including in the legislation provision for both the purchaser and the scheme company to obtain the benefit of a due diligence defence in respect of the components of the explanatory statement for which they are each responsible. This would allow the parties to delineate responsibility in the explanatory statement between the purchaser and the scheme company. The legislation should explicitly provide that defences apply to both the purchaser and the scheme company in respect of the content for which each party is responsible.

Voting on schemes (CAMAC Paper, section 4)

Class voting (CAMAC Paper, section 4.1)

First hearing

16. AAR would not support an approach whereby a Court *must* make a binding determination on classes at the first Court hearing. Equally, if a Court considers it appropriate to do so in the circumstances of a particular scheme, there should be no prohibition to stop it from doing so.

Second hearing – curative power

17. AAR supports the proposal for the Court to be given an express 'curative power' at the second Court hearing to approve a scheme in circumstances where the classes may have been wrongly constituted. We see no disadvantages or risks with this proposal, and so any additional flexibility gained by this reform would be an enhancement to the current regime. It is obviously inefficient for a company to be required to start the process again when the proposed scheme has already been approved by a requisite majority of each of the appropriate classes.

Intending controller

18. We consider that there is no need for the legislation to provide that any votes cast in favour of the scheme by an intending controller or its 'associates' be disregarded. The class composition test currently applied by the Courts has the effect that an intending controller and its controlled entities would be prevented from voting on the scheme with other shareholders. Whether other associates of the intending controller should be precluded from voting should also be determined by reference to those tests. To simply apply the definition of 'associate' in sections 12(2)(b) and 12(2)(c) and the very broad definition of 'affairs' in section 53 to a voting exclusion requirement may result in persons who would not currently be regarded as a separate class, or otherwise subject to special treatment in the context of voting on the scheme, being disenfranchised.

Abolition of the headcount test (CAMAC Paper, section 4.2)

19. AAR supports the abolition of the headcount test with no new or modified test replacing it (ie, Option 4 in the CAMAC Paper). We share the views of the Law Council submission referred to in the CAMAC Paper that the headcount test is an anachronism. Our view on the other options listed in the CAMAC Paper are as follows:

    (a) Applications to the Court for dispensation of the headcount test involve unnecessary time, cost and uncertainty. Expanding this process to include more discretion (and therefore, uncertainty) would only exacerbate this. Accordingly, we submit that Option 2 in CAMAC's Paper (namely, expanding the judicial dispensing power) should not be adopted.

    (b) We consider that retaining a modified version of the headcount test as per Option 3 in the CAMAC Paper would add unnecessary complexity, in return for no material benefit.

    (c) We oppose the adoption of Option 5, as ambivalent or uninterested shareholders should not be able to defeat transactions.

20. However, we also note that no scheme has ever been voted down on the headcount test in Australia and, while we are aware of some transactions that have not been undertaken as schemes because of concerns around the headcount test, they are few in number. We would not wish the abolition of the headcount test to be seen as a reason for opening up any of the other approval thresholds for a scheme.

The voted shares test (CAMAC Paper, section 4.2, option 5)

21. The CAMAC Paper does not expressly request submissions on the voted shares test as an independent issue, though a modification of this test is flagged in Option 5 of section 4.2 as one possible replacement of the headcount test.

22. AAR is strongly of the view that the 75% of shares voted approval threshold for schemes should be retained in its present form and not supplemented in any way. Amongst other reasons, this is consistent with our overriding views that:

    (a) schemes should be viewed as legitimate alternatives to takeover bids (or other means of securing 100% ownership, such as selective capital reductions) rather than as a mechanism to avoid them (in particular as they provide minority shareholders with forms of protection which are not provided by bids (such as Court supervision));

    (b) it would not be reasonable to attempt to draw a direct comparison between the 90% compulsory acquisition threshold and the 75% of shares voted threshold, as these measure different things and in different contexts (eg. the compulsory acquisition threshold measures the number of shares accepted into a bid over several months, at a minimum, whereas the scheme threshold focuses on the shares voted at one point in time at the scheme meeting), and transposing the compulsory acquisition test into a scheme process would effectively render the approval threshold impossible to satisfy in all but a (very) few unusual cases; and

    (c) the scheme provisions do not require revolutionary reform – that is, it's not broken so don't fix it.

23. It is important to recognise that, in practice, a 75% voted shares threshold in the context of a scheme meeting is a substantial threshold to meet, given the number of shareholders who vote at a scheme meeting will in most cases represent significantly less than 100% of the total votes held in the scheme company (ie, it is common for the proportion of shares actually voted to be in the range of 50% to 70% of total shares). In such circumstances, a 10-15% holding by a hostile shareholder (which, if voted, would represent a proportionately larger number of shares) may be sufficient to prevent a scheme being approved.

24. We note that the 75% of shares voted test is used in the context of a number of other important corporate actions, and no concern is raised to the threshold in those contexts.

Voting on cancellation schemes that include a capital reduction

25. The CAMAC Paper does not specifically discuss the additional voting requirements that apply to schemes that include a capital reduction. Nevertheless, AAR would like to take the opportunity to suggest a possible reform in this area.

26. Generally speaking, an acquisition by scheme can take one of two forms, namely, a 'transfer scheme' (under which the shares the subject of the scheme are transferred to the purchaser) or a cancellation scheme (under which the shares the subject of the scheme are cancelled). Market practice in recent years has tended to favour transfer schemes. However, there is no reason why cancellation schemes should be excluded from CAMAC's review and possible reform.

27. The CAMAC review provides an opportunity to clarify the issue of whether or not the consideration received under a cancellation scheme (which is technically provided by a third party, not the scheme company) ought to be treated as consideration that is received 'as part of the reduction' for the purposes of section 256C(2)(a). This issue is important because a cancellation of a share for no consideration is treated as a capital reduction but does not in fact reduce the company's capital to the potential detriment of creditors (and so neither the requirement in section 256B(1)(b) for there to be no material prejudice to creditors nor the duty of directors to prevent insolvent trading in section 588G apply).

28. ASIC could be given modification and exemption powers in relation to the capital reduction provisions in Part 2J.1, similar to those it has in relation to selective buy-backs (see section 256D) and Chapter 6 (and which we submit it should be given in relation to schemes, as discussed below). That way, ASIC could provide exemptions for cancellation schemes on a case by case basis where the voting requirements would otherwise give rise to anomalous outcomes. This would be similar to the practice that currently exists in the context of resolutions for section 611, item 7 approvals when all (or a majority) of shareholders would otherwise be prohibited from voting in favour of the resolution – there are numerous examples of ASIC giving relief in these circumstances by modifying item 7 to delete paragraph (a)(ii) so that all shareholders other than the purchaser (who is excluded by paragraph (a)(i)) may vote on the resolution.

29. Alternatively (or in addition), AAR submits that in such a scenario, the cancellation should be seen as a cancellation for no consideration (as it is a factual matter that no consideration flows from the scheme company itself), and so it is appropriate for sections 256B(1) (in particular section 256B(1)(b)) and 588G to have no application. This could be achieved either by way of a specific exemption to the requirements of section 256B(1) where the selective reduction occurs by way of a scheme, or amendment of section 256B.

Regulatory and judicial powers (CAMAC Paper, section 5)

ASIC exemption and modification powers (CAMAC Paper, section 5.1)

30. AAR supports ASIC being granted exemption and modification powers in relation to the scheme provisions. While this may arguably be unnecessary at the present time given that the scheme provisions are not as detailed and prescriptive as other areas of the Corporations Act, such powers would have an important role to play if any reforms resulted in additional prescription being introduced, as a 'one size fits all' approach may not be appropriate in all cases.

Section 411(17) (CAMAC Paper, section 5.2)

31. There are three separate but related aspects to the question of whether section 411(17) should be repealed:

- whether Chapter 6 'avoidance' ought to be a reason for a scheme to not be approved by the Court;
- whether there should continue to be an express formal role for ASIC to confirm that it has no objections to a proposed scheme if section 411(17)(b) is repealed; and

- whether the scheme provisions should require compliance with the Eggleston principles or any of the other principles or procedures in Chapter 6.

AAR's submissions on these issues are set out in turn below.

Chapter 6 'avoidance' – should section 411(17) be repealed?

32. AAR strongly supports the repeal of section 411(17) in its entirety. It also supports the introduction of a purposive statement to the effect that a scheme may be used to effect a transaction that could otherwise have been effected under Chapter 6.

33. As noted at the outset of this submission, in our view, it is now generally accepted within the business and legal communities that schemes are a legitimate alternative to Chapter 6 takeovers and it is therefore critical that our legal and regulatory regimes continue to treat both mechanisms as legitimate (albeit different) alternatives to effect control transactions. In this respect, we see no reason for the principle of Chapter 6 anti-avoidance in section 411(17) to be retained in any form.

34. We support a framework in which schemes continue to be seen as a legitimate form of transaction in their own right, and which offer their own forms of protection for shareholders, rather than being viewed as a mechanism by which Chapter 6 may potentially be 'avoided' (which implies some ulterior motive founded in bad faith).

35. Equally, there should be recognition that strict compliance with Chapter 6 is not always appropriate, and it is ultimately the right of disinterested shareholders to decide whether a proposal is implemented. For example, proposals which treat some shareholders differently from others or which involve collateral benefits, both of which are prohibited by Chapter 6, are permitted in schemes subject to classes being determined appropriately. In our view, this flexibility is entirely appropriate and there is no reason to see them as examples of Chapter 6 avoidance. If anything, these should be seen as examples in which an intending controller is limited in its choice of legitimate transaction mechanisms because it cannot proceed under Chapter 6 and so is 'stuck' with a scheme route. The fact that a scheme cannot be conducted on a hostile basis means that this inflexibility can be very important in practice.

A formal role for ASIC in the absence of section 411(17)(b)?

36. AAR considers that it is not strictly necessary for ASIC to continue to have an express formal role to replace section 411(17)(b) as ASIC already has standing to raise objections to a scheme if it chooses to do so. Equally, AAR would not object to ASIC being given a formal role to issue a 'no objection' letter (or advise the Court of its objections, as the case may be) at the second Court hearing.

37. ASIC has an express formal role under section 411(2) in relation to the examination of the proposed explanatory statement for a scheme before the first Court hearing. Further, a Court must not make an order convening a scheme unless it is satisfied that ASIC has had a reasonable opportunity to make submissions to the Court at the first Court hearing in relation to the proposed arrangement and explanatory statement (see section 411(2)(b)(ii)).

38. ASIC also has a general power to intervene at the second Court hearing, pursuant to its general powers under section 1330.

39. Accordingly, there is no doubt that ASIC has the right and power to intervene in relation to a scheme if it wishes (whether at the first or second Court hearings). The real question is whether the scheme provisions should expressly require it to make representations to the Court as to whether or not it has any objections. That is, should the Court have the benefit of ASIC's views in all cases, especially at the second Court hearing stage?

40. As noted above, in our view, an express role for ASIC at the second Court hearing is not strictly necessary. Presumably, if ASIC did not appear at the second Court hearing, the Court would take comfort from the fact that ASIC was notified of the second Court hearing and elected not to appear. ASIC should not necessarily have to confirm in writing that it has no objections and/or does not wish to appear.

41. Nevertheless, we anticipate that the Courts will in practice continue to look to ASIC to provide independent guidance as a form of comfort in exercising their general discretion as to whether to approve a scheme on fairness grounds. That being so, AAR can see legitimate scope for ASIC being given a formal role at the second Court hearing and would not object to this. AAR considers that if such a role is introduced, it should require ASIC to either:

    (a) issue a letter confirming that it has considered the proposed scheme and does not wish to appear (AAR considers that ASIC should not be required to make a positive statement that it has no objections, as in some cases it may be that ASIC identifies one or more minor issues which it considers to be immaterial or not of a nature that it wishes to raise in Court, but which may cause it to be uncomfortable in making an absolute statement that it has no objections); or

    (b) appear at the second Court hearing to make submissions to the Court as to any objections that it wishes to raise (ASIC should not be required to appear if it has no objections).

42. As it would be anomalous if ASIC could delay the process by refusing to issue a letter and also refusing to appear, if such an approach is adopted then if ASIC chooses not to appear then it should be taken to have no objections.

Compliance with the Eggleston principles or other Chapter 6 rules or procedures

43. AAR does not support the introduction of any requirement for schemes to comply with any of the rules or procedures in Chapter 6. This includes key rules such as:

- the 4 month minimum price rule (section 621(3));
- the rule that all offers must be the same (section 619);
- the prohibitions on escalators and collateral benefits (section 622 and 623) – in this regard, AAR wishes to take the opportunity to note that it considers that the prohibition on escalators in section 622 serves no useful purpose in practice (especially as it is so easily avoided) and ought to be repealed, and would submit that CAMAC should recommend this as part of its ultimate report; and
- rules on the effect of acquisitions outside of the 'bid period' (section 651A) and the prohibition on disposals during the 'bid period' (section 654A).

The rationale for this is simple: schemes are different from takeover bids and provide different (and in our view, no less onerous) protections – the most important being the class voting requirements – and so there is no need to include additional prescriptive rules in relation to such matters. Briefly, the protections include:

- minimum price: a prospective purchaser who purchases in the lead up to a possible scheme assumes the risk that the scheme company may insist on an equivalent (if not higher) price and that it may be required to proceed with a Chapter 6 bid (in compliance with section 621(3)) if a scheme cannot be agreed, and the duties of the scheme company's directors also offer protection;
- offers to be the same: protections that exist if offers differ between shareholders include the scheme company directors' duties to act in the interests of the company as a whole (rather than favouring particular shareholders) and the class voting rules;
- collateral benefits: protection for those shareholders who are not offered collateral benefits under a scheme is clearly afforded by the class voting rules; and
- acquisitions outside of the 'offer': protections include the 20% limit in section 606 and the fact that the acquisition of additional securities does not necessarily assist the prospective purchaser under a scheme given the class voting requirements (and as discussed below, the scheme company directors can regulate such acquisitions in any event if they consider this to be a material issue) – this can be contrasted with a bid under which acquisitions outside of the bid can assist the bidder to satisfy its minimum acceptance condition.

Further, the flexibility that schemes provide is a key reason why they are a useful and legitimate alternative to takeover bids, and this flexibility should not be reduced.

44. In any event, if the scheme company is concerned by any such matters, it can regulate them in the implementation agreement. In this regard, the fact that schemes can only be undertaken with the support of the scheme company's board (and that the fact that the board is in turn bound by statutory and fiduciary duties) is itself a form of protection for shareholders. This is therefore another reason why prescriptive rules based on Chapter 6 are unnecessary and inappropriate for schemes. This can be contrasted with a potentially hostile Chapter 6 takeover offer under which there would be no protections for shareholders in the absence of the prescriptive rules and procedures in Chapter 6 – this is simply not the case with a scheme.

45. AAR does not consider it necessary for the Court to be specifically required to have regard to the Eggleston principles in section 602 when considering schemes. However, if this approach is adopted, AAR considers that this should only be one factor that may be taken into account by the Court as part of its overall discretion and should not of itself be determinative. AAR does not support any requirement or directive:

- for the Court to not approve a scheme if it departs from the Eggleston principles (whether or not there is a 'good reason' for the departure); or

- for the scheme company (or the prospective purchaser) to make submissions to the Court on Eggleston principle issues in the absence of an objector (including ASIC) raising this is as a specific area of concern in a particular case.

Extension and simplification of schemes (CAMAC Paper, section 6)

Options and convertible notes (CAMAC Paper, section 6.1)

46. AAR does not consider it appropriate for holders of options or other convertible securities to participate as such in members' schemes. Such holders are simply not members. They can always choose to participate by exercising or converting before the record date if exercise or conversion is permitted under the terms of issue of the option or security.

47. AAR also considers that the current practice whereby a prospective purchaser can insist on having inter-conditional schemes for options and convertible securities in addition to the share scheme works effectively as a means by which a purchaser may seek to reach 100% ownership of all classes of securities.

48. However, AAR also considers that the treatment of holders of such securities as creditors is artificial and inappropriate. It is certainly the case that option holders are not creditors in the true sense of the word. Further, holders of convertible notes or other hybrid securities are not really creditors of the company in a control scheme context – although their securities may take the form of debt (or have certain debt-like features), the only reason the purchaser is seeking to acquire them is because they have the capacity to convert into equity – so treating them as creditors is artificial.

49. Accordingly, AAR submits that the scheme provisions should be amended so that:

    (a) they apply to any class of security (in the same way that a bid must be made for a class of securities), not just shares or securities that have 'membership' rights – though perhaps this should be limited to securities that are convertible into equity (so that pure debentures and debt securities are not covered);

    (b) in relation to voting on schemes that relate to securities other than shares, votes held by security holders should be determined by reference to the value of their securities, similar to the treatment in creditors' schemes under the current legislation; and

    (c) it is made clear that options are to be treated as one class of securities irrespective of whether there are different exercise prices, vesting rights or exercise periods/dates (that is, even if different prices are offered for different options, there should be no requirement for separate class votes so long as the same methodology (such as a Black-Scholes methodology) has been applied consistently across the various options to determine the value of the consideration in each case) – this would be similar in approach to ASIC's policy on classes of securities in Section C of RG159.

Managed investment schemes (CAMAC Paper, section 6.2)

50. AAR would support the scheme provisions being extended to apply to interests in managed investment schemes. There are numerous reasons for this - but in essence, the key is that there does not appear to be any good reason why schemes should only be available to companies when a material proportion of the market for securities comprises managed investment schemes (or 'stapled' groups which include a managed investment scheme as one component).

51. AAR would support the scheme provisions being extended to both listed and unlisted managed investment schemes. Given that schemes are voluntary mechanisms, if an unlisted managed investment scheme does not wish to use a scheme then it doesn't have to, but we see no reason why the choice and opportunity to pursue a scheme of arrangement should be limited to listed managed investment schemes.

Other aspects (CAMAC Paper, section 1.5)

Section 414 (CAMAC Paper, section 1.5.2)

52. AAR would support the repeal of section 414. The section is rarely used and does not appear to perform a useful function, and there does not appear to us to be any good reason to reform it or any demand in the market for such reform.

Contact details

53. Please contact any of the following if you would like to discuss our submission or have any queries in relation to it:

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Allens Arthur Robinson
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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]

[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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Dear John

CAMAC Discussion Paper - Members Schemes of Arrangement

We refer to the CAMAC discussion paper "Members Schemes of Arrangement" dated June 2008 (**Discussion Paper**).

As requested in section 5.3 of the Discussion Paper we have prepared submissions on whether section 411 (17) should be repealed, retained in its present form or amended. We apologise for the lateness of our submissions and thank you for accepting them.

As you are aware, our colleagues Stan Lewis and Katrina Sleiman have also prepared a submission in response to the Discussion Paper. We support their submissions on supplementary disclosure and set out our additional submissions in relation to 411(17) below.

Evolution of the scheme process

The mechanism and protections in Chapter 5 have evolved over time to develop into a legitimate alternative to takeovers. Unlike Chapter 6 which was specifically drafted as a change of control regime, schemes have evolved from provisions dealing with court supervised arrangements between a company and its creditors. Over the years, legislation has been tailored to use this procedure for change of control situations. However much of the evolution has developed from judicial involvement in the scheme process.

Justice Lindren has queried the purpose that is served by court supervision of schemes[1] and has cautioned that market participants should not overestimate the protection available under the scheme procedure in Chapter 5, "*It should not be thought that the court's consideration of the question that a meeting be convened can even begin to come to grips with issues of the kind that might be raised by the target's shareholders in a contested inter partes proceeding*".

With respect to Justice Lindgren's view, we consider that court supervision plays an important role in protecting target shareholders in schemes. While it is indisputable that

[1] Justice Lindgren "Private equity and section 411 of the Corporations Act 2001 (Cth)", (2008) 26 *C&SLJ* 287.

issues that arise under schemes are complex (and indeed schemes are often better suited to complex transactions than are takeovers), counsel for the target has a duty to bring all material matters to the court's attention. In ex-parte matters such as schemes, this duty is particularly relevant. This professional obligation as well as the reputation risk involved in withholding information goes a long way to ensuring the court is aware of all the information it needs to assess the scheme.

Further, judicial involvement in schemes has resulted in some admirable outcomes for shareholders. For example, in cash schemes funds must be held in an account on trust for shareholders out of which the cash consideration is paid when the scheme is implemented. This provides even greater settlement certainty for shareholders than under cash bids where protections are limited to disclosure around funding arrangements. There has also been judicial scrutiny of "naked no vote" break fees. These are break fees payable by a target where the scheme is rejected by the target's shareholders, despite the absence of any competing offer from another bidder. In particular the decision in the Bolnisi Gold scheme suggests that while "naked no vote" break fee provisions are likely to be unenforceable if they are found to be contrary to the interests of the target or its shareholders or would coerce target shareholders into voting in favour of the offer, irrespective of its underlying merits.

In our view a triumph of the scheme process is that it allows independent scrutiny of friendly deals by both ASIC and the courts. Friendly takeovers on the other hand are not subject to the same scrutiny, and while the same statutory protections exist regardless of whether the deal is hostile or friendly, the risk of challenge in a friendly takeover context is low.

Our point is – schemes work. That is not to say that the regime may not benefit with a thorough and considered policy review. However, we do not agree with a piecemeal approach that concentrates on section 411(17) in isolation and does not consider it in the overall context of change of control protections.

Process should not undermine protection

We agree with arguments in the Discussion Paper and other submissions on this issue that schemes are a legitimate alternative to takeover bids and that the market should be free to choose the mechanism by which change of control transactions are conducted. The submissions put forward on this issue show that the choice between a scheme and a takeover is frequently driven by which process best suits the structure of the transaction. For example, it is well recognised that schemes may be preferable where greater certainty in timing is required, where transactions are particularly complex or where bidders cannot (usually for funding reasons) run the risk of acquiring less than 100% of the target.

A bid may be preferable where the bidder wishes to retain flexibility in timing and improving consideration to respond to a rival bid or where an agreement has not been or cannot be reached with the target.

However, while bidders and targets are free to take advantage of the process that best suits their change of control transaction, shareholders should be afforded the same protections regardless of the process by which the change of control will occur. Choice of

procedure should not undermine the underlying safety net for those whose shares are being acquired.

What purpose does section 411(17) serve?

We submit that considering shareholder protections is a necessary step of any change of control transaction. Currently section 411(17) provides for this step as part of the scheme process. We do not agree that section 411(17) poses an "undue completion risk"[2] but rather see it as serving an important purpose of actively bringing shareholder protection to ASIC and the court's attention.

That section 411(17) exists is an indication that without specific consideration of the protections provided under takeover bids, the shareholder protection regimes of schemes and bids would not be aligned. This section ensures scheme proponents and the court actively consider the shareholder protections afforded under Ch 6 in the context of the proposed scheme. This may not have been the original purpose of this section but it is the foundation on which scheme jurisprudence has been built. Although section 411(17) does not achieve harmony between the shareholder protections of takeovers and schemes, it achieves a better outcome than not considering shareholder protections at all.

602 principles

Given the important purpose served by section 411(17) we would support the repeal of section 411(17) only if the step of considering shareholder protection was otherwise retained. The Discussion Paper and review of the scheme provisions presents an opportunity to achieve greater harmony between takeovers and schemes by incorporating the section 602 principles into Ch 5.

Replacing section 411(17) with specific reference to 602 principles would provide a legislative basis for the court to review and decide whether or not to approve the scheme.

We submit that, in any event, it is not illogical to apply the 602 principles to schemes as the language of section 602 in theory covers any control transaction. Section 602 provides that the purposes of Chapter 6 are to ensure that:

(a) *the acquisition of control over voting shares* takes place in an efficient, competitive and informed market;

(b) shareholders know the identity of any person who proposes *to acquire a substantial interest in the company*, have a reasonable time to consider the proposal; and are given enough information to enable them to assess the merits of the proposal;

(c) shareholders have a reasonable and equal opportunity to participate in any benefits offered under *any proposal under which a person would acquire a substantial interest in the company*, body or scheme; and

(d) an appropriate procedure is followed as a preliminary to compulsory acquisition of voting shares. (our italics)

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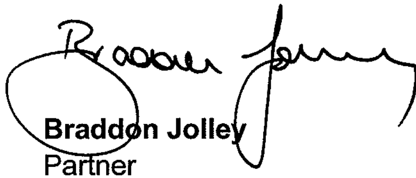
[2] Ref Damian and Rich

Conclusion

Although the process of section 411(17) may be clumsy, the underlying protections afforded to shareholders are not, in our view, expendable. We would support a thorough (rather than piecemeal) policy review which involved considering the appropriateness of incorporating the 602 principles into the scheme process.

Yours faithfully
Corrs Chambers Westgarth



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Submission to the Corporations and Markets Advisory Committee

Members' Schemes of Arrangement

Discussion Paper

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Introduction

This submission addresses the release of the CAMAC Discussion Paper on *Members' Schemes of Arrangement* (June 2008). Some of the suggestions that have been provided in this submission are of a policy nature and question the need to modify the Members' Scheme of Arrangement, a mechanism used for achieving structural change within a company or a corporate group.

If any of the responses require further explanation please contact Claudia Koon Ghee Wee at UNSW ASB School of Banking and Finance at c.wee@unsw.edu.au or Marina Nehme at the UWS School of Law at M.Nehme@uws.edu.au.

Academics involved in producing this response

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General Observations:

The discussion paper, *Members' Scheme of Arrangement* (June 2008), analyses the need to modify the Members' Scheme of Arrangement, a mechanism used for achieving structural change within a company or a corporate group.

The observation made in this submission can be summarised in the following manner:

- Schedule 8 Part 3 provisions need to be appealed. This needs to be done when repealing reg 5.1.01. The directors' recommendation and the expert report requirements need to be introduced in the statute.
- There is a need for greater regulatory guidance concerning supplementary disclosure.
- Schemes of arrangements should have their own regimes of liability and defences.
- Incorporation of "in the best interest of members" test into the "fair and reasonable" test and use the combined test for both bids and schemes.
- Courts should not have express powers in relation to predetermining classes of members in a scheme of arrangement.
- The Headcount should be abrogated. There should be one exception and that is in the case of companies limited by guarantee.
- ASIC's exemption and modification powers should remain the same.
- Section 411(17) needs to be modified to take into consideration the Eggleston principles.

Introduction

The move to review members' scheme of arrangement is very important because the procedure that leads to a scheme of arrangement has not substantially been modified since its introduction to the Australian system in the beginning of the 20th century. Accordingly, our laws may be archaic in relation to this area and may need revamping. This review of schemes of arrangement is a desired move to keep our legislation up to date and competitive with overseas systems especially in view of the financial crisis that is starting to manifest itself in the United States of America and that may expand all over the world.

It is crucial for Australia to have a competitive member scheme of arrangement because it is in times of financial difficulty that these types of scheme would be most popular. For instance, after the October 19, 1987 Black Monday when NASDAQ crashed, research has found a significant increase in same industry takeovers, stock-financed takeovers, size of acquirers, and market-to-book ratio of assets of acquirers in the after-crash period relative to the before-crash period.[1] After the Korean currency crisis in 1997, Korean government has urged their domestic blue chip enterprises to merge their principal businesses to strengthen their business structure

[1] Vijay Gondhalekar, Vijay and Yatin N Bhagwat, Yatin N., "Evidence on Takeover Characteristics and Motives in the Acquisitions of NASDAQ Targets following the Stock Market Crash of 1987" (2000), EFMA 2000 Athens, University of Michigan Working Paper.

and profitability.[2] In Asia, during the financial crisis, cross border mergers and acquisitions were very popular. Such cross border mergers and acquisition in five countries in Asia during that peris reached a record level of US$11 billion in 1998 and US$15 billion in 1999. Before the crisis in 1996, the amount was US$2.6 billion.[3]

Accordingly, if the current global crisis reaches Australia, possibilities of mergers and acquisitions (especially cross border mergers and acquisitions) will be abundant and we need to have a competitive system in place to allow such transactions to go forward. Further, even under normal circumstances, many acquisitions are carried out through scheme of arrangement. The Financial Services Institute of Australasia noted that 'in the last 5 years, nearly 40% of all large (greater that $1 billion) change-of-control transactions have been carried out as schemes of arrangement'.[4]

Chapter 3: Information to shareholders

Possible changes to facilitate effective disclosure of scheme information to shareholders, including in relation to the content and method of disclosure:

The current disclosure system in relation to scheme of arrangement is cumbersome and needs to be in compliance with s 412 of the *Corporations Act* 2001 (Cth), reg 5.1.01 and Schedule 8 Part 3 of *the Corporations Regulations* 2001 (Cth).

The adequacy of the information given to shareholders is to be assessed by the court in a practical and realistic way.[5] For instance, Emmet J noted the following:

> The explanatory memorandum is substantial. It contains extraordinarily detailed information and material relating to the financial position and business of AMP and its subsidiaries, including projections as to the position following the demerger of AMP, on the one hand, and HHG, on the other. I have been taken by senior counsel for AMP to the significant aspects of the explanatory memorandum. It has not been possible, nor is it appropriate, for the court to examine the whole of such a complex document in detail. However, I am satisfied that the scheme that has been propounded by AMP is appropriate to be put before the shareholders of AMP for their consideration.

Such complexity may mean that mum and dad investors will not be able to understand and assess the impact of the explanatory statement made for the purpose of a scheme of arrangement. For this reason, there is a need to introduce a 'clear, concise and effective' requirement for the explanatory statement. This may assist shareholders to understand the scheme proposal on which they are asked to vote. This will also be in compliance with the courts requirement in relation to the disclosure documents. As

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[2] Hee-Jin Kang, Hee-Jin and Almas Heshmati, Almas, "An Evaluation of Korean M&A Policy in the Post-Currency Crisis", (2007) 3(1) ICFAI Journal of Mergers & Acquisitions (2007), Vol. III, No. 1, pp. 21-42.

[3] James Zhan and Terutomo Ozawa, *Business Restructure in the Asia: Cross Border M&A in the Crisis Period* (2001),11.

[4] Financial Services Institute of Australasia, *Takeover Package* (2006) 18, <http://www.finsia.com/Content/NavigationMenu/Media_centre/Mediareleases/2006archive/Takeovers_package_0406.pdf > viewed on 23 September 2008.

[5] *Re Crusader Ltd* [1996] 1 Qd R 117.

noted in the CAMAC discussion paper, Austin J observed that ''it is more useful… to give a concise and clear summary of the effect of the changes which is materially comprehensive.'[6] This is especially needed in case of complex disclosure document.

We agree with Damian and Rich that the Schedule 8 Part 3 provisions need to be appealed. This needs to be done when repealing reg 5.1.01. The directors' recommendation and the expert report requirements need to be introduced in the statute.

Further, we also agree that that the information should be lodged with ASIC and the shareholders should receive a brief roadmap of that information, together with reference to a website where the full information is available.

This has a number of benefits:

- The shareholders would be able to receive a summary of the important information. This will make it easier for mums and dads investors to understand the proposal. If they need more information, they can access the documents online.

- This may reduce the cost of scheme of arrangement.

- The use of the internet is welcomed. It is more environmentally friendly and it also maximise the use of technology available at our disposal. There is a need to rely more and more on the technology that is easily available to society. While doing so, it is of importance to assess the number of people who have access to such technology. The Australian Bureau of Statistic gathered the following information:[7]

Business Use of Information Technology, Summary Indicators - 2002-03 to 2005-06

	2002-03	**2003-04**	**2004-05**	**2005-06**
Computer use (%)	83.0	85.2	88.6	88.8
Internet use (%)	71.4	74.2	76.8	81.3
Web presence (%)	23.0	25.1	26.7	29.8

As it can be noted, the level of use of information technology is rising over time. In 2005-2006, 81.3% of the businesses are using the internet in one form or other. This number is bound to increase in the coming years. This empirical data supports the authors' anecdotal evidence of the use of the internet in the commercial world.

- More and more discussion is related to the need for the introduction of the use of internet disclosure. For instance, CAMAC's discussion paper on external administration referred to a number of options that related to online disclosure in the case of voluntary administration.

[6] Re Mirac Ltd (1999) 32 ACSR 107, 112.
[7] Australian Bureau of Statistics, "Business Use of Information Technology 2005-2006".

Further the court has allowed for notices of meetings of scheme of arrangement to be sent electronically.[8] Such a move is important and illustrates that the importance of the internet in our day to day life. The law in relation to scheme of arrangement should allow notice in relation to the scheme to be sent electronically. This would be in accordance with s 249J(3) and (3A) that permit notice of meeting to be send electronically.

Whether there should be greater statutory guidance concerning supplementary disclosure

We agree with Damian and Rich proposal in relation to this matter. There is a need for a clear regime in relation to supplementary disclosure. The new regime may note that the company that is subject to the scheme of arrangement must first approach ASIC (not the court) before releasing supplementary information. We do not believe that the court should be involved at the time of the issue of the supplementary information. In case of irregularity, the court may take such irregularity into consideration during the second hearing.

Whether the required standard for formulation of an expert's opinion should be more consistent between bids and schemes (Section 3.4)

We are of the view that the required standard for formulation of an expert's opinion should be more consistent between bid and schemes.

The issue arises from the seemingly different requirements for expert opinion under bids and schemes. For bids, s 640(1) of the Corporation Acts 2001 requires expert opinion "that states whether, in the expert's opinion, the takeover offers are ***fair and reasonable*** and gives the reasons for forming that opinion". On the other hand, for Schemes of Arrangement, Schedule 8 Rule 8303 of the Corporations Regulations 2001 requires expert opinion to state "whether or not, in his or her opinion, the proposed Scheme is in the ***best interest of the members*** of the company the subject of the Scheme and setting out his or her reasons for that opinion". Regulatory guidance for the definitions of "fair"[9] and "reasonable"[10] are given in ASIC Regulatory Guidance 111:

RG111.10:

> Under this convention, an offer is '***fair***' if the value of the offer price or consideration is equal to or greater than the value of the securities the subject of the offer. This comparison should be made assuming 100% ownership of the 'target' and irrespective of whether the consideration is scrip or cash. The expert should not consider the percentage holding of the 'bidder' or its associates in the target when making this comparison. For example, in valuing securities in the target entity, it is inappropriate to apply a discount on the basis that the shares being acquired represent a minority or 'portfolio' parcel of shares.

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[8] *Re Alinta Ltd (No 2)* [2007] FCA 1378.

[9] ASIC Regulatory Guide 111 RG 111.10

[10] ASIC Regulatory Guide 111 RG 111.12

RG111.12: When deciding whether an offer is ***reasonable***, an expert might consider:

(a) the bidder's pre-existing voting power in securities in the target;
(b) other significant security holding blocks in the target;
(c) the liquidity of the market in the target's securities;
(d) taxation losses, cash flow or other benefits through achieving 100% ownership of the target;
(e) any special value of the target to the bidder, such as particular technology, the potential to write off outstanding loans from the target, etc;
(f) the likely market price if the offer is unsuccessful; and
(g) the value to an alternative bidder and likelihood of an alternative offer being made.

On the other hand, there is no statutory or regulatory definition of the term "in the best interest of members". The definition of "best interests of the members" seems to be derived from the term "fair and reasonable"[11]; and the basis of evaluation selected by the experts must be appropriate to the nature of the specific transaction. A summary diagrammatical illustration of the relationship between the terms "fair and reasonable" and "best interests of the members" is given in Diagram 1.

This issue is further complicated by the contradicting interpretations on whether "fair and reasonable" is equivalent to "best interest of the members". Current legislation does not provide clear guideline by which the term "in the best interest of members" is to be evaluated. A review of current experts' reports revealed that the term "fair and reasonable" is considered to be equivalent to "best interest of the members" in current industry practice; yet in some instances these two terms are interpreted differently, leading to the view that the legislative test for Schemes differs from that applicable to a Chapter 6 takeover bid.[12] Some researchers[13] have commented that ASIC holds the view that "fair and reasonable" is to be equated with "in the best interest of members". However, upon closer examination of ASIC Regulatory guide, it seems that the "fair and reasonable" term is only equivalent to "in the best interest of members" term under two opposing situations – when the transaction is considered to be either "fair and reasonable", or when it is "not fair and not reasonable". In other words, when the transaction is "reasonable but not fair"[14], the term "fair and reasonable" does not equate "in the best interest of members".

According to ASIC Regulatory Guide 111, Schemes have to be in the "best interest of the members".[15] Whether a transaction is "in the best interest of members" can be implied from the "fair and reasonable" test if the transaction is entirely

[11] ASIC Regulatory Guide 111 RG111.15-111.19
[12] S E K Hulme QC, "Section 640 of the Corporations Law: Independent Experts' Reports and the RTZ Ltd Takeover of Comalco Ltd" (2001) 19 C&SLJ 134 at 143-4; Shears v Chisholm [1994] 2 VR 535 at 600-602
[13] For example, McDonald, L., Moodie, G., Ramsay, I., and Webster, J. (2003), Experts' Reports in Corporate Transactions, The Federation Press, at p.59; and Damien, T., and Rich, A. (2004), Schemes, Takeovers and Himalayan Peaks – The Use of Schemes of Arrangement to Effect Change of Control Transactions, Freehills Publication, at p.127
[14] ASIC Regulatory Guide 111 RG 111.14
[15] ASIC Regulatory Guide 111 RG111.17-111.19

"fair and reasonable" or "not fair and not reasonable". If a transaction is "reasonable but not fair", experts have to proceed to explain whether the transaction is in the best interest of the members. It is possible for a transaction to be "reasonable but not fair" yet still is in the best interest of the members if the consideration does not equal to or greater than the value of the securities the subject of the scheme, yet there are sufficient reasons for security holders to vote in favor of the scheme in the absence of a higher offer.[16]

To complicate the issue further, the words "fair and reasonable" in s 640 is not regarded as a compound phrase,[17] meaning that it is possible for an offer to have a split assessment for being "reasonable but not fair".[18] Below is a summary chart in regards to expert report for Schemes in accordance to ASIC Regulatory Guide 111:

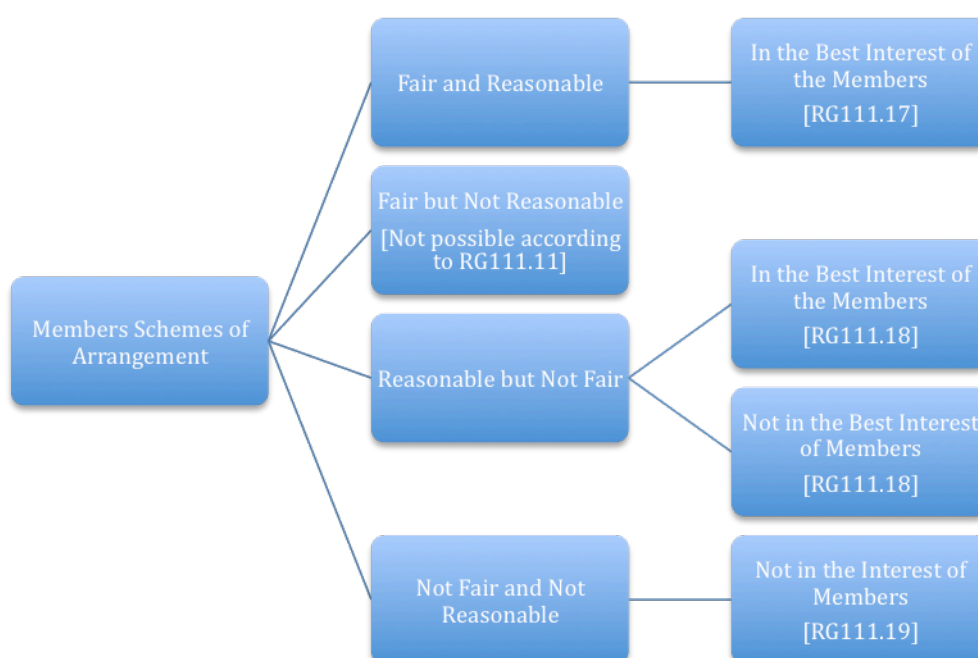

Diagram 1: The Relationships between "Fair and Reasonable" and "Best Interests of Members" under Members Schemes of Arrangement

Under the Schemes, it appears that the "best interest of members" test is redundant (though the correct wordings are still required) except when the transaction is "reasonable but not fair". If bids and Schemes are truly functionally comparable (with the exception to hostile takeovers), then experts should only focus on the purpose and outcome of the transaction, and not be made to tailor their wordings to suit either bids or Schemes – as suggested in ASIC Regulatory Guide 111 RG 111.4 "... An expert should focus on the purpose and outcome of the transaction, that is, the substance of the transaction, rather than the legal mechanism used to effect the transaction."

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[16] ASIC Regulatory Guide 111 RG111.18
[17] ASIC Regulatory Guide 111 RG 111.9
[18] ASIC Regulatory Guide 111 RG 111.14

We suggest the incorporation of "in the best interest of members" test into the "fair and reasonable" test and use the combined test for both bids and Schemes. To a large extent, how the "fair and reasonable" test is currently interpreted is rather open-ended[19], hence either its statutory or regulatory definition should be further clarified to reduce the potential variable interpretation. Intuitively, it makes sense to consider a transaction as "fair and reasonable" only if it is in the best interest of the members of related companies.

Whether the liability and defences for disclosure breaches for schemes should be similar to those for bids

We agree with Damian and Rich proposal in relation to this matter. It is anomalous for scheme of arrangement not to have its own regime of liability in relation to misleading and deceptive conduct. As mentioned in CAMAC's discussion paper, Takeover, fundraising, financial services and product disclosure documents have their own disclosure regime. Similarly scheme of arrangement should have stand alone liability and defences. The due diligence defence should be introduced for scheme of arrangement defective disclosure documents.

Further, s 1041H(3) should be amended to exclude the application of this section to schemes of arrangement. It should note:

> 'Conduct:
>
> (a) that contravenes:
>
> (i) section 670A (misleading or deceptive takeover document); or
>
> (ii) section 728 (misleading or deceptive fundraising document); or
>
> ***(iii) Part 5.1 (misleading or deceptive scheme of arrangement documents)***
>
> (b) in relation to a disclosure document or statement within the meaning of section 953A; or
>
> (c) in relation to a disclosure document or statement within the meaning of section 1022A;
>
> does not contravene subsection (1). For this purpose, conduct contravenes the provision even if the conduct does not constitute an offence, or does not lead to any liability, because of the availability of a defence.'

[19] McDonald, L., Moodie, G., Ramsay, I., and Webster, J. (2003), Experts' Reports in Corporate Transactions, The Federation Press, at p.64

Chapter 4: Voting on Schemes

Class Voting:

First hearing:

Damian and Rich proposal in relation to giving the court express power, at the first court hearing, in relation to the composition of classes or relevance to the voting process of extrinsic interest. We do not agree with such a proposal. Even though it has some benefit in relation to adding certainty to shareholders meeting, it may diminish the flexibility of the scheme of arrangement. Further shareholders may not have a reasonable opportunity to be heard on an application to a court for a binding determination on class composition at the first hearing.

Additionally, ASIC's RG 142 (at [44]) notes that ASIC ensures when looking at the scheme documents that the determination of classes for voting is fair and equitable between those classes having regard to their rights and obligation. This may protect the interest of different classes of shareholders.

Second Hearing:

We agree with Damian and Rich proposal that the court should be given express curative power at the second hearing.

Intending controller:

We believe there is a need to clarify the position of an intending controller. It may be a desired to incorporate in the statute a section that is based on RG 142 [at 46]. Intended controllers should be required to fully disclose their interest and should not be allowed to vote in favour of the resolution to approve the scheme.

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

We support option 4: Dispense with the headcount test. The 50% Headcount test is inconsistent with the economic precept underpinning the Corporations Act (one vote= one share). Further, it may create an incentive for 'share splitting'. We also agree with the law Council's argument for abolishing the headcount test.

The headcount test as it applies to companies limited by guarantee

Limited by guarantee companies should have special provisions that may allow headcount test to be conducted in scheme of arrangements.

Chapter 5: Regulatory and judicial powers

Whether there should be some change to the ASIC exemption and modification powers in regard to schemes

There is no justification to change ASIC's exemption and modification powers in regard to schemes.

However such power is given to ASIC, an appeal from ASIC's exercise of those powers should be to the Administrative Appeal Tribunal and not the Takeover Panel. Clear distinction need to be set between a takeover and members scheme of arrangement. They are not the same and the takeover panel should not have a say in relation to this matter.

Whether changes need to take place in relation to s 411(17)

We agree with George Durbridge to amend s 411(17) to explicitly incorporate the Eggleston principles for change of control schemes; and we agree that the court should not approve a takeover Scheme if it departs from the Eggleston principles without a good cause. We also are of the opinion that ASIC's 'no objection' statement power should be retained or enhanced to protect shareholders of the relevant companies.

It is of upmost importance that shareholders' protection is upheld and fairness of transaction has been ensured in any bids or Schemes condition, in order to promote a safe environment for future investors to invest. If s 411(17) was repealed, ASIC's role in reviewing Schemes would greatly diminish, signifying a loss of shareholders' protection.

Chapter 6: Extension and simplification of schemes:

No comment

Conclusion:

In conclusion, we are of the view that mergers and acquisitions increases shareholders' wealth by ensuring companies' competitiveness in various aspects. Threat of mergers and acquisitions protect shareholders from mismanagement of a company since they allow alternative management teams to compete for the control of the company's assets; hence reduces the potential monitoring costs shareholders have to pay to monitor managers' performance due to asymmetric information; and at the same time motivates managers to perform better to maximize shareholders' wealth.

Considering the role of mergers and acquisitions in promoting Australian financial and economical wellbeing, any modification of current legal and financial system that does not hinder the progress towards cultivating a more competitive mergers and acquisition should be encouraged, provided that

stakeholders' interests are well protected. It is also financially and economically intuitive to design a legal system that provide ample protection to shareholders, since ruthless takeovers activities can shake the very core of a country's financial stability. Australian financial market will become more competitive and attractive to both domestic and international investors if the processes of any potential mergers and acquisitions have been made more efficient.

26 September 2008

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26 September 2008

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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

Michael Barr-David

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AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS
ABN 11 008 484 197

26 September 2008

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee

By email to john.kluver@camac.gov.au

Dear Mr Kluver

CAMAC DISCUSSION PAPER – MEMBERS' SCHEMES OF ARRANGEMENT

Thank you for the opportunity to make a submission to CAMAC in relation to the Discussion Paper.

The Australian Institute of Company Directors (AICD) is a member institute for directors that is dedicated to making a positive impact on the economy and society by promoting professional directorship and good governance. AICD delivers education, information and advocacy to enrich the capabilities of directors, influence the corporate governance environment in Australia and promote understanding of the role of directors. With offices in each state and more than 23,000 members, AICD represents a diverse range of corporations, from the top 200 publicly listed companies to not for profits, public sector entities and smaller private family concerns.

In this letter we highlight the issues in the Discussion Paper which are of particular significance to directors.

SIGNIFICANT DIRECTOR ISSUES
Section 3.3 - Liability and defences for disclosure breaches

AICD supports the proposal that the information supplied in an explanatory statement under a scheme should be subject to a stand-alone liability and defence regime modelled on that applicable to bids.

The Discussion Paper does not suggest who would bear the liability under such a scheme. However, we note that Mr Alan Cameron AM in his CAMAC submission makes the point that "those responsible for the statements are frequently not the commercial movers of the transaction." We agree with Mr Cameron's submission that it is not sensible that the directors of the scheme company are responsible for "material being put forward by the promoter of the scheme, who would otherwise have been the bidder under a takeover."

Accordingly, AICD considers that any liability and defence regime should allow explanatory statements to identify who takes responsibility for the various sections of that statement, and for liability to be attributed accordingly.

Section 6.2 - Managed investment schemes

The scheme provisions should extend to managed investment schemes (MIS). MIS are a very common investment vehicle in Australia and a large number of directors sit on the boards of responsible entities. Such an extension would logically align with the extension of the takeover provisions to listed MIS and would have a number of benefits:

- the supervisory role for the Courts and ASIC would better protect the interests of members;
- it would significantly reduce the complexity of the current use of informal "trust schemes" and would increase certainty and efficiency in such transactions;
- with the significant presence of stapled entities in the market, extension of the scheme provisions to MIS would end the artificial situation which presently exists, where courts considering a proposed scheme are strictly limited to looking to the company and not the MIS (unless a concurrent trust advisory declaration is also sought).

The scheme provisions should be extended to unlisted MIS as well as listed MIS, where an unlisted MIS has 50 members or more. We agree with the view set out in section 6.2.2 that there is no rationale for limiting the extension of the scheme provisions to listed MIS. The rationale for limiting the extension to unlisted MIS with 50 members or more would align with the takeover provisions.

Given that unlisted MIS are not within the purview of the Takeovers Panel and so do not receive the protection of Guidance Note 15 (Listed Trust & Managed Investment Scheme Mergers), the protections offered by such an extension are of greater significance to unlisted MIS than to listed MIS.

Section 6.4 - Schemes opposed by the company

The scheme provisions should certainly not be adapted to facilitate their use where a target board opposes the proposal. Where a potential controller is making a hostile approach to an entity, a bid is the appropriate vehicle to be used. The availability of a "hostile" scheme is inconsistent with the character of a scheme as emanating from the entity. The alterations to the scheme process required for hostile schemes would be significant and entirely unnecessary given that an appropriate mechanism already exists under the bid provisions.

The creation of hostile schemes would likely lead to lower premiums being offered to members. Presently, where a potential controller is proposing a scheme there is a significant incentive to make it attractive to encourage directors to put the proposal to members. This would no longer be the case, if potential controllers were able to circumvent target boards. AICD accepts that a contrary argument can be made that members ultimately decide and that permitting hostile schemes provides a greater opportunity for member democracy. However, AICD submits that the reason that schemes have a lower threshold than takeovers is due to the

combination of regulatory, court **and target** supervision of the proposal and the process. Where all elements of that supervision are not present, a takeover is the appropriate route for a control transaction.

If you have any questions in relation to our submission, please contact Gabrielle Upton (02) 8248 6635 or myself.

Yours sincerely

[SIGNED]

John H. C. Colvin
CEO

CD AUSTRALIAN INSTITUTE OF COMPANY DIRECTORS
ABN 11 008 484 197

Australian Shareholders' Association
Standing up for shareholders

ASA Submission: CAMAC Discussion on Members Schemes of Arrangement

The ASA is pleased to be able to contribute to the discussion on members schemes of arrangement and to comment from the perspective of the retail shareholders. The uses of members' schemes have evolved over time, whilst the relevant provisions of the Corporations Act 2001 have remained largely unchanged.

The ASA supports legislative change to ensure that the scheme process continues to offer mechanisms for the protection of retail shareholders, can be made more efficient both in terms of time and cost and where appropriate to remove differences between the scheme and bid processes.

The ASA

The Australian Shareholders' Association (ASA) is a not-for-profit organisation formed to represent, protect and promote the interests of investors in shares, managed investments, superannuation and other financial investments.

Submission

Part 3 Information to Shareholders

Effective Disclosure

The CAMAC Members Schemes of Arrangement Discussion Paper (the paper) discusses the disclosure requirements of section 412 of the Corporations Act 2001 (the Act). The voluminous documents accompanying both schemes and bids frequently overwhelm retail shareholders. The experience of the ASA is that retail shareholders confronted with this excess of information do not know where to begin and frequently do not read any of the material provided.

The ASA supports the suggestion contained in the paper to introduce a 'concise, clear and effective requirement' to the explanatory statement.

Part 3.1.2 of the paper makes suggestion of a 'road map' of the information to be made available to shareholders. The ASA would supports this suggestion. The role of the court and ASIC in considering and reviewing scheme documents provides sufficient safeguards to ensure that the 'roadmap' contains the appropriate information.

The ASA also supports information being provided in a summary form with reference to the full information, which could be accessed either on the web or by requesting the hard copy.

Many shareholders either do not have internet access, or lack the confidence to access this information on the web. Accordingly the 'roadmap' and any summary documents should be both available on line and provided in hard copy to shareholders. Likewise any document incorporated by reference should be available either online or upon request, by post.

Supplementary disclosure

The ASA supports a supplementary disclosure regime for schemes similar to that which applies to bids.

Experts Opinion

The 'best interests' of diverse groups of shareholders will vary. Given this and the efficiency and simplicity of having the same test for both bids and schemes, the ASA supports the application of the 'fair and reasonable' test to schemes.

Part 4 Voting on Schemes

Class Voting

The ASA supports the status quo on the determination of voting classes. Any determination at the outset of proceedings which becomes binding is likely to disadvantage shareholders. At this stage particularly there is likely to be an imbalance of information between the shareholders and the company. Given this imbalance it is more appropriate that the court be able to determine that the classes were not properly constituted at a second hearing, even if this may lead to delay and additional cost in the case of court decision in favour of dissident shareholders.

Headcount Test

The purpose of the headcount test is to protect small shareholders. However given the low numbers of shareholders who generally vote in schemes, as evidenced in the paper, it is not an effective protection measure and as noted could in fact be used by a larger shareholder to block a scheme. The Act currently provides the court with a much more effective means of protecting small shareholders, in the discretion to refuse approval.

Accordingly the approval of schemes should be on the basis of a special majority of 75% of the votes cast on the resolution. In addition there should be a 90% entitlement test of for compulsory acquisition to take effect.

Part 5 Regulatory and Judicial Powers

ASIC exemption and modification powers

The ASA the supports expansion of ASIC's role in schemes to give it general exemption and modification powers, provided that this change would reduce the time and cost of schemes of arrangement.

In the event that a short form merger procedure not requiring shareholders approval for wholly owned corporate groups is not adopted, then ASIC should have the power to exempt companies from complying with the shareholder disclosure requirements.

Purpose and Comparable Protections Test

The paper identifies the application of section 411(17) as the cause of uncertainty during the scheme procedure. It is obviously in the interests of shareholders to avoid situations arising where the bulk of the costs of a scheme are incurred before the scheme can be certain of success.

However cost and time considerations must be balanced against the need provide protection for retail shareholders, who are less likely to understand the intricacies and consequences of the proposals or to be able to mobilise to ensure their views are placed before the court to be considered as part of the courts wider fairness discretion.

The paper quotes an argument that as no scheme has been rejected on the basis of section 411 (17) that the section has no practical function. This

argument does not however take into account the effect which the review process carried out by ASIC prior to the hearing might have in ensuring that applications which come before the court are fair. Given that the role of the court is not investigatory, the ASA supports a continued role for ASIC in reviewing schemes and advising the court of 'no objection'.

Part 6 Extension and Simplification of Schemes

Options and Convertible Noteholders

Holders of options and convertible notes are currently treated as creditors and as such dealt with by a creditor scheme. Option and convertible note holders however have deferred their right to become shareholders and accordingly it is more appropriate that they be treated as shareholders in a scheme than as creditors.

Managed Investment Schemes

Although the Takeovers Panel has issued a Guidance Note requiring various voting and disclosure procedures to apply to trust schemes, without the judicial oversight provided by the scheme provisions, unit holders are not sufficiently protected.

Applying the scheme provisions to managed investment schemes would provide unit holders with the protection and oversight of the court, as well as provide a simpler and more transparent process for all parties.

Mergers within Corporate Groups

The short form merger process proposed in section 6.3 of the paper for intergroup re-structuring is supported by the ASA. Shareholders do not require the protective measures provided by the court, or the disclosure requirements for change of control schemes in these circumstances. Accordingly it is in the interests of shareholders that the process should be made efficient both in terms of time and cost.

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Attention: Mr John Kluver
Corporations and Markets Advisory Committee
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SYDNEY NSW 2001

By email: john.kluver@camac.gov.au

30 September 2008

Dear Sir

Thank you for the opportunity to comment on the issues raised in CAMAC's discussion paper on "members' schemes of arrangement". RiskMetrics (formerly Institutional Shareholder Services) is the world's largest proxy voting advisory firm, providing governance research to more than 1700 institutional investors in Australia and around the world.

Scope of CAMAC's review

RiskMetrics notes that, while this discussion paper focuses on members' schemes, CAMAC has invited comment on other matters such as creditors' schemes and share acquisitions under s. 414. RiskMetrics also notes that the discussion paper examines the role of share capital reductions in change of control transactions. However, as CAMAC is aware, share capital reductions are now rarely used to effect changes of control or consolidate control through the removal of minority shareholders (see Damian and Rich, Schemes, *Takeovers and Himalayan Peaks* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2004), pp. 9-10).

The same cannot be said for share buy-backs. Moreover, a company does not need to implement a selective buy-back (with its higher threshold for shareholder approval) in order to consolidate control of the company in the hands of a majority or substantial shareholder. That can be achieved through an on-market buy-back or an equal access buy-back. A majority or substantial shareholder can, by not participating in these buy-backs, increase its shareholding of the company. This being the case, RiskMetrics believes that CAMAC should consider examining the role of buy-backs in change of control transactions as part of these "other matters". As part of such a review, CAMAC should give consideration as to whether, in line with the Class Exemptions to the New Zealand Takeovers Code, a shareholder whose control of a company will be increased by a buy-back and its associates should be precluded from voting on the resolution required for on-market buy-backs and equal access buy-backs (which exceed the 10/12 limit).

Schemes of arrangement and protection of minority shareholders

Hostile change of control transactions are one of the most effective ways of enforcing good corporate governance. The threat that an unsolicited takeover bid will be made for a company and that control of the company will pass into the hands of a hostile outsider has proved very effective in ensuring that directors will monitor management and that both directors and managers will be accountable to their company's shareholders for underperformance or mismanagement. When designing or reviewing the mechanisms by which a change of control can be effected, it is essential – from the perspective of good corporate governance – to consider the appropriate balance between, on the one hand, facilitating hostile changes of control and thus increasing the efficiency of the market for corporate control and, on the other, protecting the interests of minority shareholders.

Change of control transactions effected by way of a members' scheme of arrangement are, however, inherently "friendly" in nature – in marked contrast to the mechanism for takeover bids in Chapter 6 which is neutral in this regard. The role of the target company in implementing a scheme makes it impracticable for schemes to be used to effect a change of control that does not have the support of the target company's directors and management (see Damian and Rich, pp. 56-57; Colla, 'Scheme Warfare: Navigating Contests for Control in Friendly Takeover Schemes' (2008) 26 C&SLJ 191, at 191). Accordingly, "improvements" to the Australian scheme mechanism will ultimately rebound to the benefit of the incumbent directors and management and may, in some cases, facilitate their entrenchment. RiskMetrics therefore takes the view that the options for reform detailed by CAMAC in its discussion paper need to be considered primarily from the perspective of protecting the interests of minority shareholders.

Disclosure

RiskMetrics supports the proposal to incorporate in the scheme of arrangement mechanism disclosure requirements (and defences) equivalent to those that apply to Chapter 6 takeover bids. This would have the benefit of formalising what has been the practice in relation to schemes of arrangement under which shareholders have been provided with information, in the notices of meeting for a scheme and accompanying explanatory notes, equivalent to that which they would have received under Chapter 6. This is also, as CAMAC notes, consistent with ASIC's current policy in reviewing draft scheme documents.

Shareholder meetings and the role of the court

RiskMetrics supports Damian and Rich's proposal that the court should be given the power to make a binding determination at the first court hearing on how shareholders are to be marshalled into classes. This will go a considerable way to reducing the uncertainty in the current scheme mechanism, where: (i) the process by which shareholders holding the same legal class of shares may be placed in different classes for the purposes of voting on a scheme is essentially a subjective process have regard to the rights and possibly also the extraneous interests of each shareholder (see Austin and Ramsay, *Ford's Principles of Corporations Law* (LexisNexis Australia, Looseleaf edition), para [24.110]; Renard and Santamaria, *Takeovers and Reconstructions in Australia* (LexisNexis Australia, Looseleaf Service), para [1519]); and (ii) it is only at the second court hearing, after the class meetings have already been held, that the company's division of its shareholders into different classes is confirmed or rejected. Damian and Rich's proposal would ensure that the company and hence its shareholders do not bear the expense of a scheme of a scheme being rejected at the second hearing simply for failure to divide the shareholders into the correct classes.

Damian and Rich's related proposal to give the court the power at the second meeting to "cure" procedural irregularities in relation to the shareholder approval process for schemes also has considerable merit, and RiskMetrics supports this proposal. This will make clear that the court's power to cure procedural irregularities in relation to meetings generally under s. 1322 applies to scheme meetings. It will also remove the prospect of "all or nothing" outcomes at the second hearing by allowing the court, for instance, to disregard votes that have been improperly cast by the bidder and its associates or validate class meetings, including where shareholders claim that they been placed in an incompatible class, as an alternative to rejecting the scheme.

Headcount test

RiskMetrics believes that the headcount test in s. 411(4)(a)(ii)(A) of the *Corporations Act* should be retained in its current form. The recent introduction of the words "unless the Court orders otherwise" addresses the criticisms that have been levied at the headcount test (eg that it creates a perverse incentive for share-splitting: see Damian and Rich, p. 133) while its retention provides

minority shareholders with an additional level of protection. This latter point is particularly important given the lower threshold for shareholder approval that needs to be obtained under s. 411(4)(a)(ii)(B) to eliminate minority shareholders compared to the threshold required to achieve a compulsory acquisition under Chapter 6A.

Shareholder voting

RiskMetrics would like to draw CAMAC's attention to the following aspects of shareholder voting in relation to schemes, each of which has the potential to cast doubt over the integrity of the shareholder approval mechanism for schemes, especially in the context of close results. CAMAC will be aware of the example of Rebel Sport in March 2007 where the proposed scheme of arrangement was approved by a very slim majority amidst concerns over discrepancies in the voting process: see *In the Matter of Rebel Sport Limited (No 2)* [2007] FCA458, at paras 7 and 9.

(i) **Audit trail for proxy voting**

Under the present system of proxy voting, the holders of shares or those entrusted with the exercise of voting rights attaching to shares do not receive from either the company or the company's share registry any confirmation as to the number of votes lodged and voted and the manner in which the votes were cast. This lack of an audit trail means that custodians, fund managers and superannuation funds as well as retail investors are unable to ascertain whether their proxies have been accepted by the company and exercised in the manner directed.

RiskMetrics wishes to draw CAMAC's attention to IFSA's submission on improving the proxy voting system in Australia made to the Parliamentary Joint Committee on Corporations and Financial Services (as part of the Committee's inquiry in 2007 into shareholder engagement and participation). RiskMetrics supports IFSA's recommendation that a meaningful audit trail from companies and their share registries to shareholders be implemented, so that shareholders can have confidence that their voting rights and any voting instructions given by them have been respected by the company.

(ii) **Cut-off date for proxy voting**

In addition, under the present system of proxy voting in Australia, there are two cut-off dates that are relevant to the ability to cast votes via proxies: proxy appointments must be received by a company at least 48 hours before a meeting (*Corporations Act*, s. 250B(1)); and the company's determination of voting entitlements for a meeting must be based on the persons who were shareholders not more than 48 hours before the meeting (*Corporations Regulations*, reg. 7.11.37(3)). The coincidence of these two cut-off dates creates the potential for discrepancies between the votes lodged via proxies and the votes held at the second of these cut-off dates (as, despite the flexibility in the first cut-off date, the company is effectively required to reconcile the votes lodged with voting entitlements no more than 48 hours before a meeting).

RiskMetrics wishes to draw CAMAC's attention in this regard to IFSA's submission (referred to in (i) above). IFSA's proposal to have an earlier date for determining voting entitlements – 5 business days before the meeting, rather than 48 hours – will provide sufficient time for this reconciliation of votes lodged with voting entitlements to implemented accurately. By reducing the time pressure for this reconciliation, this proposal will better ensure that shareholders' proxy appointments and voting instructions are respected and will also facilitate the creation of an audit trail.

(iii) **Oversight of votes**

It appears incongruous to RiskMetrics that those persons who may have a material interest in the outcome of a shareholder vote should have the responsibility for oversight of that vote (either directly or indirectly via board-appointed agents such as auditors or share registries). This material interest will clearly be present where the scheme involves a management buy-out or other acquisition which, if implemented, would result in the incumbent directors and management of the target company receiving shares in the bidder or the merged entity.

The UK *Companies Act 2006* contains provisions that address this issue and which, if adopted in Australia, would allow shareholders (the UK threshold for this is equivalent to the 5% voting power/100 headcount thresholds that apply under the *Corporations Act* to the rights of shareholders to requisition meetings and put resolutions at meetings) with concerns about the result of a poll at a scheme or other meeting to call immediately for the poll to be reviewed by an independent assessor: ss. 342-344. The UK provisions also entitle shareholders to have an independent assessor appointed ahead of a poll being taken to oversee the poll.

At present, in Australia, if the directors of the company decline to have a result reviewed, the only recourse of the shareholders is to seek to have ASIC review the result after it has been declared. ASIC investigations can be problematic due to the short space of time between the scheme meeting and the court hearing in which the final orders to approve the scheme of arrangement are made.

(iv) **Securities loans**

The recent regulatory scrutiny of short selling worldwide has also focused attention on the principal means for facilitating short selling, namely securities loans. However, apart from allowing market participants to source shares for the purposes of short selling, securities loans enable the effective "borrowing" of voting rights free of the economic interest in the company that ordinarily accompanies voting rights.

Under a securities loan, shares are "lent" temporarily to a borrower against the return of equivalent shares. This so-called loan involves the transfer of title to the shares to the borrower but the economic incidents of the shares remain with the lender (as the borrower is required to pay to the lender amounts representing dividends and other distributions received on the shares during the term of the loan and, on termination of the loan, equivalent shares will be returned to the lender at a pre-agreed price).

As voting rights to shares pass with title, the borrower has use of the votes attaching to the shares for the term of the loan. The lender retains no right to vote the shares during the term of the loan. The standard form contract used in the Australian market – the Australian Master Securities Lending Agreement – provides for the borrower to use its best endeavours to vote the borrowed shares in accordance with the lender's wishes (cl. 4.3) but, in practice, the only way in which the lender can be certain that the shares are voted as desired is by terminating the loan and "recalling" equivalent shares from the borrower.

The "decoupling" of voting rights from an economic interest in the company carries the potential for shares to be borrowed for the sole purpose of casting the votes attaching to the shares: see Hu and Black, 'Equity and Debt Decoupling and Empty Voting II: Importance and Extensions' (2008) 156 *University of Pennsylvania Law Review* 625, at 641. This can distort the results of shareholder voting, particularly in relation to controversial matters or other matters on which shareholder views are finely balanced. The voting result in that situation may not necessarily reflect the interests of the majority of shareholders that hold

both title to and the economic incidents of shares. This is of even greater concern in the context of a scheme of arrangement as the borrower of shares could easily be placed in a class where the borrower has no commonality of interest with the other members of the class (and the vote that class could be decisive in determining whether or not the scheme proceeds).

Securities lending, when used to "borrow" votes, can also have an effect beyond the shares actually borrowed. Even if not voted, those shares are no longer available to the lender (unless recalled) nor do they form part of the free float of shares of the company. This has the potential to influence the outcome of a close contest by withdrawing votes from, for example, the opposition to a proposed scheme. Moreover, where the borrowed shares are actually voted in favour of a scheme, the impact on the opposition is effectively doubled (the votes are not available to them or their potential supporters and have, instead, been voted against them).

RiskMetrics believes that the concerns raised by the decoupling of voting rights and economic incidents can be addressed by making securities lending activity more transparent. While the substantial shareholder disclosure provisions in Chapter 6C of the *Corporations Act* are capable of being triggered by securities loans in respect of substantial shareholdings, those provisions are not specifically directed at securities loans and nor do they specifically address the concerns with securities loans. RiskMetrics has closely followed the recent changes to the regulation of short selling in the Australian market (and also in other markets) and strongly supports the proposal – set out in the Commentary released by the Australian Treasury on the exposure draft of the *Corporations Amendment (Short Selling) Bill 2008* – for the disclosure of all securities lending transactions.

Section 411(17)

RiskMetrics does not support the proposal to repeal s. 411(17). The repeal of this provision has, as CAMAC notes, the potential to reduce ASIC's role in reviewing schemes and that, particularly in the case of relatively complex schemes, may be to the detriment of minority investors. The utility of s. 411(17) lies not so much in the over-arching requirement that a scheme must not be used for the purpose of avoiding Chapter 6 (which, in practice, has not been used by the courts as a basis for rejecting schemes) but in the fact that that provision enables ASIC to ensure that schemes are implemented in a manner consistent with the Eggleston principles (see ASIC, 'Schemes of Arrangement – s411(17)', *Regulatory Guide 60*, 1999, at 60.8; Lindgren, 'Private Equity and Section 411 of the Corporations Act 2001 (Cth)' (2008) 26 C&SLJ 287, at 291).

RiskMetrics, instead, strongly supports the solution suggested by Mr George Durbridge (CAMAC, p. 71). This has the dual benefits of ensuring that ASIC's current role in the review of schemes is not lessened (the repeal of s. 411(17) carries the risk of undermining the protection afforded to minority shareholders by ASIC's involvement) and addressing the uncertainty created by the present wording of s. 411(17) (see Renard and Santamaria, para [1507]). Mr Durbridge's proposal, if implemented, would also ensure clarity as to the uniformity of regulatory treatment of change of control transactions effected via schemes and Chapter 6 bids and, moreover, would eliminate any problem of regulatory arbitrage where a scheme is resorted to mainly for the purpose of by-passing the more rigorous requirements of Chapter 6.

RiskMetrics also notes that, while ASIC is explicitly given a reasonable opportunity under s. 411(2) to review the draft scheme documentation, it has no such luxury in relation to its production of a statement for the purpose of s. 411(17)(b). This time pressure means, in particular, that ASIC, as a practical matter, is forced to rely on the information provided to it by the company as regards the outcome of the shareholder vote and the manner in which votes by proxy have been dealt with and cast. In the absence of any requirement for an audit trail or independent oversight of the voting process, there is a risk that ASIC may be compelled to issue a statement under s. 411(17)(b) that is

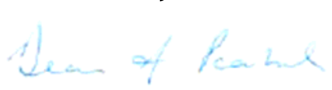
based on flawed information provided by the company. The lack of sufficient time for ASIC to undertake a review of shareholder vote (when coupled with the lack of an audit trail and independent oversight) has the very real potential to undermine the protection afforded to minority shareholders by ASIC's review of schemes.

Managed investment schemes

RiskMetrics supports the extension of the scheme of arrangement mechanism to both listed and unlisted management investment schemes. ASIC involvement and judicial review will, as CAMAC notes, provide minority shareholders with a formal measure of protection that is currently lacking in relation to change of control mechanisms such as "trust schemes".

Please do not hesitate to contact us if you would like to discuss any aspect of our submission in more detail. Thank you once again for the opportunity to comment on the issues raised in your discussion paper.

Yours sincerely



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Mr John Kluver
Executive Director
CAMAC
GPO Box 3967
Sydney NSW 2001

Dear Mr Kluver,

Members' Schemes of Arrangement

I have pleasure in enclosing a submission which has been prepared by the Corporations Committee of the Business Law Section of the Law Council of Australia in response to CAMAC's Discussion Paper on Members' Schemes of Arrangement.

I confirm that the submission has been endorsed by the Business Law Section. Owing to time constraints it has not been considered by the Directors of the Law Council of Australia.

Should you wish to discuss any aspect of this submission, in the first instance please contact the Committee Chair, Greg Golding, on [02] 9296 2164.

Yours sincerely,

Bill Grant
Secretary-General

29 September 2008

Enc.

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Corporations and Markets Advisory Committee - Discussion Paper on Members' Schemes of Arrangement

Submission on behalf of the Law Council of Australia - Business Law Section, Corporations Committee

1 Background and content

This submission contains the response of the Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committee**) to the Corporations and Markets Advisory Committee's (**CAMAC**) June 2008 Discussion Paper on members' schemes of arrangement.

The Committee welcomes the opportunity to comment on the Discussion Paper.

Please note that this submission has been endorsed by the Business Law Section. However, owing to time constraints, it has not been considered by the Council of the Law Council of Australia.

This submission contains responses to questions regarding the following topics raised in the Discussion Paper:

(a) information to shareholders (**section 2**);

(b) voting on schemes (**section 3**);

(c) regulatory and judicial powers (**section 4**);

(d) extension and simplification of schemes (**section 5**); and

(e) other aspects of members' schemes that may benefit from further consideration (**section 6**).

The Committee has been concerned to ensure that members' schemes of arrangement work predictably to enable effective class decisions to be made on a wide variety of transactions, not all of them control transactions, and that members' ability to make those decisions and have them approved by the Court is not inhibited by uncertain, outdated or anomalous provisions. This involves removing doubts as to the availability of the scheme provisions in certain cases and providing mechanisms to satisfy ASIC and the Court that an informed and appropriately constituted class has approved a scheme.

2 Information to shareholders

Feedback sought	Committee's comments
Possible changes to facilitate effective disclosure of scheme information	Harmonised disclosure is an area in which the Committee has a particular interest and strongly endorses (see attached draft paper entitled "Harmonised Disclosure Proposal").

to shareholders, including in relation to the content and method of disclosure (section 3.1)	**Introduction of a 'clear, concise and effective' requirement** The Committee supports the introduction of a clear, concise and effective requirement for scheme documentation. The Committee considers that, as the requirement currently applies to disclosure documents of a similar nature to scheme documentation, its application to scheme documentation is appropriate and would formalise market practice. **Provision for incorporation of information by reference into explanatory statements / lodgement of complete information with ASIC and provision of summary disclosure to shareholders** The Committee supports these proposals and considers that they would assist in achieving clear, concise and effective disclosure, reducing the volume of explanatory statements and reducing cost for scheme companies, while still allowing interested shareholders to access all relevant information. The Committee considers that encouraging two levels of disclosure is appropriate. This should be facilitated through the inclusion of permissive provisions in Part 5.1 which allow a scheme company to produce: • a short form explanatory statement containing material information in summary version which would be sent to shareholders; and • a long form explanatory statement or supplement containing detailed information and full copies of longer documents (including expert's and accountant's reports and implementation agreements) which would not be required to be sent to shareholders. Hard copies of long form explanatory statements and any documents incorporated by reference should be made available to shareholders on request. In the Committee's view, this approach would assist in achieving clear, concise and effective disclosure. **Omission or revision of specific disclosure obligations in Corps Regs Schedule 8 Part 3** The Committee considers that the disclosure provisions contained in Schedule 8 of the Corporations Regulations should be repealed, other than those regarding directors' recommendation and independent experts report requirements which should be incorporated into Part 5.1 of the Corporations Act. Recommendations regarding specific disclosure changes are contained in the Annexure.
Whether there should be greater statutory guidance concerning supplementary disclosure (section	The Committee considers that the introduction of a clear statement of supplementary disclosure requirements in a scheme context (applicable to the period between despatch of the explanatory statement and the scheme meeting) would clarify disclosure obligations and assist in achieving consistency of practice.

	As regards the logistics of supplementary disclosure in a Court supervised regime, the Committee considers that an appropriate approach is as follows: • **test for disclosure:** the applicable disclosure test should be comparable to the test contained in subsections 643(1) and 644(1) of the Corporations Act; • **bidder involvement**: in a takeover scheme context, only the scheme company should be permitted to make supplementary disclosure. If a bidder becomes aware of the need for supplementary disclosure, it should be obliged to notify the scheme company, as under section 670C of the Corporations Act; • **despatch**: there should be no mandatory requirement to despatch a supplementary statement to shareholders. This is consistent with takeover requirements; • **lodgment and Court involvement**: a supplementary statement should be lodged with ASIC, ASX and the Court. However no formal review of the supplementary statement by ASIC or the Court prior to despatch should be required. The Committee considers that there should be no obligation on the scheme company to apply to the Court for an order in respect or consequence of the issue of the supplementary statement. However a scheme company should be permitted to apply to the Court for orders relating to the supplementary statement at its discretion. The Committee notes that this position is consistent with supplementary disclosure requirements contained in Chapter 6 of the Act, and believes that it would assist in ensuring timely disclosure and recognises that many supplementary bidder's or target's statements are issued on a precautionary basis. The power to consider what implications (if any) the supplementary disclosure has for the scheme process should remain with the Court. For example, where material information is provided close to the date of the scheme meeting, the Court would have the power to order a deferral of the scheme meeting. ASIC could be given the power to apply to the Court for an order relating to a supplementary statement which is proposed or has been sent. Other parties would have the opportunity to raise issues relating to the supplementary statement at the second Court hearing. • **variation of scheme terms**: the Committee considers that it would be appropriate for the supplementary statement regime to be used to effect variations of certain terms of a takeover scheme (for example, those contained in section 650B of the Corporations Act), with more complex variations requiring prior Court approval.
Whether the liability and defences for disclosure breaches	The Committee considers that the current position whereby explanatory statements are covered by the general misleading and deceptive regime in sections 1041H and 1041I of the Corporations Act and not by a specific due

for schemes should be similar to those for bids (section 3.3)	diligence defence regime (such as applies to bidders' and targets' statements and prospectuses) is unsatisfactory.[1] Given the similarity of purpose and content of scheme explanatory statements to other disclosure documents which do have the benefit of statutory due diligence defences, the Committee considers that this protection should be extended to information supplied in an explanatory statement. This could be achieved through the introduction of a stand alone liability and defence regime applicable to schemes. As to which existing regime such a liability and defence regime should be modelled on, while the Committee recognises that the model contained in Part 6D.3 of the Act would be appropriate, in the Committee's view the primary goal should be to ensure consistency with the liability and defence regime applicable to Chapter 6, that is, use of the model contained in section 670D of the Act. The Committee notes that a necessary part of this proposal is that the scheme company in a takeover scheme context should be required to obtain the bidder's consent to the inclusion in the explanatory statement of material relevant to the bidder, in particular disclosure regarding securities proposed to be issued under the scheme, and that the bidder have the same defences as the scheme company.
Whether the required standard for formulation of an expert's opinion should be more consistent between bids (currently 'fair and reasonable') and schemes (currently 'in the best interests') (section 3.4)	The Committee considers that the takeover formulation of an expert's opinion of 'fair and reasonable' may not be appropriate for all schemes. For example, in respect of a demerger, the issue for shareholders is better put as whether the proposal is in their best interests, rather than whether the terms on offer are fair and reasonable. However, if consistency of opinion formulations between takeover bids and schemes is desired, the Committee considers that an appropriate alternative formulation, which would be equally applicable to bids and the various types of schemes, would be whether the expert is of the opinion that shareholders should vote in favour of, or accept, the proposal.

3 Voting on schemes

Feedback sought	Committee's comments
Comment on class voting proposals (section 4.1)	**Whether the Court should be given an express power at the first Court hearing to make a binding determination on the composition of classes and an express 'curative power' to approve schemes in the case of classes being wrongly constituted** The Committee supports these proposals and considers that giving the Court an express power to make a binding determination regarding composition of classes would add certainty to the scheme process and reduce completion risk. The Court's determination of the appropriateness of classes could only be binding based on the facts before the Court at the time. For this reason, the

[1] See also proposals in attached draft paper entitled "Harmonised Disclosure Proposal".

	Court's power to make a determination as to classes should be expressed to be subject to such terms and conditions as the Court sees fit.[2] The Committee considers that the additional flexibility associated with giving the Court an express 'curative power' at second Court hearing to approve a scheme even if classes wrongly constituted is desirable and appropriate. The Committee also considers that it would be helpful to give power to the Court in schemes to bind option holders to fix a nominal voting entitlement where there is a lack of certainty as to value of the 'debt and claims' of holders of different series of options (and therefore of their voting entitlements).[3]
	Whether the position of an intending controller in a change of control scheme be clarified by specifically disregarding any votes in favour by that person and associates The Committee considers that specifically disregarding any votes in favour of a scheme by an intending controller and its associates would create inherent difficulties. In particular, the concept of association as defined in paragraphs 12(2)(b) and (c) of the Corporations Act is not an appropriate test of eligibility to vote on a scheme. To automatically disregard the votes of any associate (of the type referred to in section 12(2)(b) or (c) of the Corporations Act) may result in the votes of certain shareholders (such as those who have entered into voting arrangements with an intended controller) being disregarded in situations where they may not be under the current class test, which focuses on community of interest within a class. Currently it is expected that an intending controller and its related bodies corporate do not vote, or vote as a separate class, as do any other members of the company who would be affected differently from the general body of members.[4] The Committee considers that this current expectation, together with the power to ask the Court to make a determination as to classes and the Court's curative power offer an appropriate level of commercial certainty in this area.
Comment on 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 Committee considers that the headcount test should be removed,[5] leaving the voted shares test and the requirement for Court approval and agrees with the Law Council's previously communicated views on this issue as reflected in section 4.2.4 of the Discussion Paper. The Committee is of the view that modifying the voted shares test to 90% is not desirable, nor is a participation threshold. In particular, the Committee considers that the procedural protections implicit in a scheme of arrangement (namely target board approval and Court sanction) mean that it is not necessary to impose a 90% threshold as required for

[2] For example, in relation to the participation of foreign shareholders in a scheme, the Court could rule that they do not constitute a separate class, provided that certain conditions regarding their holdings and treatment under the scheme are met.

[3] This could be applied to creditors' schemes also.

[4] ASIC Regulatory Guide 142 at [RG 142.46].

[5] The Committee notes that the issues around this test related to share splitting and nominee arrangements and have been addressed to a degree by the amendments to section 411(4) in 2007 to allow the Court to approve the scheme despite the fact that the headcount test has not been strictly satisfied. However the Committee notes that there remain issues with the current legislation (as discussed in section 4.2.4 of the Discussion Paper).

	compulsory acquisition under Chapter 6A of the Corporations Act. Further, it is not possible to compare the scheme threshold (which is a percentage of shares voted on the scheme) with the takeover threshold (which is a percentage of all shares). To impose a requirement that 90% of the shares voted at the meeting be voted in favour of the scheme would have the result that any scheme could be defeated by a very small percentage of the voting shares in the company. Finally, the Committee notes that a 75% approval requirement is consistent with the established use of an appropriate 75% majority to implement key decisions regarding a company, including liquidation, changes to constitutions, variation of class rights and selective reductions of capital.
Comment on the headcount test as it applies to companies limited by guarantee (section 4.2.5)	As eliminating the headcount test leaves companies limited by guarantee without a mechanism for approval of schemes, the Committee considers that the voting requirement for companies limited by guarantee should be amended to 75% of members who vote on the resolution.

4 Regulatory and judicial powers

Feedback sought	Committee's comments
Comment on whether there should be some change to the ASIC exemption and modification powers in regard to schemes (section 5.1)	The Committee considers that it may be appropriate to give ASIC exemption and modification powers in relation to Part 5.1 corresponding with section 655A of the Corporations Act. This would be particularly important if more prescriptive procedural or disclosure requirements are incorporated in Part 5.1.
Whether section 411(17) should be repealed, retained in its present form or amended (section 5.2)	The Committee considers that section 411(17) in its current form creates undue uncertainty and 'completion' risk in a context where it is well established that a scheme can be used to effect a control transaction. The Committee agrees with Damian and Rich's suggestions (as outlined in section 5.2.2 of the Discussion Paper) that: • in addition to repealing section 411(17), a purposive statement be introduced into the scheme provisions acknowledging that schemes can be used to change control to clarify that the two regimes are true alternatives. This would assist in avoiding any uncertainty regarding the interaction between Chapters 5 and 6 of the Act; and • technical 'equality of opportunity' rules drawn from the bid provisions would be inappropriate for schemes as the combination of the class voting test, along with the disclosure of all material information and the Court's fairness discretion ensure that there is a fully informed disinterested vote. For completeness, the Committee notes that it does not support the alternative suggestions contemplated in section 5.2 of the Discussion Paper (that is, retaining section 411(17) or amending section 411(17)) for the reasons

	expressed by Damien and Rich in section 5.2.2 of the Discussion Paper.

5 Extension and simplification of schemes

Feedback sought	Committee's comments
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)	**Whether option holders and noteholders should be given some right to participate in members' schemes** The Committee considers that the participation of option holders and noteholders in schemes of arrangement is appropriate and desirable. The Committee considers that the present uncertainty as to whether option holders are appropriately included in members' or creditors' schemes needs to be resolved. The Committee acknowledges that there are different views as to whether option holders are more appropriately included in members' or creditors' schemes, however the Committee would endorse an approach in which the legislation expressly acknowledges that option holders can be bound by a scheme of arrangement, be it a members' or a creditors' scheme. The Committee notes for completeness that, as it is widely accepted that note holders are creditors, the same issues of uncertainty do not arise in relation to note holders. For consistency, the Committee also considers that the Court's discretion to dispense with the headcount test should also apply to voting by option holders. The Committee also reiterates its views expressed in section 3 above that it would be helpful to give power to the Court in option holders' schemes to fix a nominal voting entitlement where there is a lack of certainty as to value of the 'debt and claims' of option holders (and therefore of their voting entitlements).
Whether, and if so in what manner, the scheme provisions should extend to listed managed investment schemes (section 6.2.1) and unlisted managed investment schemes (section 6.2.2)	The Committee agrees in principle with the extension of the scheme provisions to listed managed investment schemes (**MIS's**), but notes that there will likely be complexities in drafting the relevant provisions. In addition to promoting member protection by creating a supervisory role for ASIC and the Court, the Committee considers that there are a number of other advantages in extending the scheme provisions to listed MISs: **Certainty** - although Courts have held that it is appropriate and within power to amend MIS constitutions to facilitate a trust scheme of arrangement, there remains a risk of a Court finding that company law principles of fraud on the minority and oppression (including the Gambotto principle) apply in trust cases. If this was the case, informal trust schemes of arrangement would not be possible. **Extension of regulatory relief to trust schemes** - the Corporations Act relieves acquirers from the need to issue a prospectus or PDS in respect of

	consideration securities where shares are acquired under a Part 5.1 scheme of arrangement.[6] This (and ancillary relief from the on-sale provisions of the Corporations Act[7]) has not been extended to informal trust schemes and therefore, in the absence of specific ASIC relief, a regulated disclosure document is needed for a trust scheme. This produces an unbalanced result in the case of a scheme of arrangement involving a stapled group consisting of one or more companies and trusts. It would be easier to motivate an extension of regulatory relief if trust schemes become subject to Part 5.1. In addition, some foreign jurisdictions exempt acquirers from the need to issue formal disclosure documents under foreign laws where securities are issued to foreign members under an Australian Court-sanctioned scheme of arrangement.[8] A trust scheme of arrangement, however, is not sanctioned by the Court. Even if judicial advice is sought under a state based act[9], there is some doubt as to whether this will be recognised as a Court-sanctioned scheme[10]. **Consistency in treatment of stapled groups** - In theory, a Court charged with considering a Part 5.1 scheme of arrangement in relation to a company forming part of a stapled group should limit its enquiries to that part of the transaction which relates to the company. In practice, such a distinction is artificial given members are being invited to make a decision in relation to their holdings in the stapled group as a whole. In extending its jurisdiction to include stapled trusts, the Court should be formally empowered to assess the transaction in its entirety based on a single set of criteria. **Passing of title under transfer schemes** - An informal trust scheme of arrangement is implemented through an arrangement between members and the trustee (as persons who are bound by the constitution). The prospect of a successful challenge to a transfer by a creditor which has a charge or other security over a transferor's securities would seem to be higher than in the case of a Court-ordered scheme of arrangement. This is undesirable given the need for certainty and finality. It would be necessary to override contrary provisions in constituent documents if Part 5.1 was extended to listed MISs. This would be consistent with the principled position that mandatory acquisitions should occur either following the acquisition of a certain percentage of securities following a Chapter 6 takeover or under a Court sanctioned scheme of arrangement (which brings with it the protection of ASIC involvement, class voting and prescribed voting thresholds).

6 Section 708(17) exempts an offeror from the requirement to prepare a prospectus in connection with a Part 5.1 scheme of arrangement. The Corporations Act has been modified by C0 07/9 to provide that a product disclosure statement is similarly not required where an offer or issue of financial products occurs under a Part 5.1 scheme of arrangement.

7 ASIC CO 07/42.

8 Reciprocal recognition is given to foreign schemes under ASIC CO 07/44.

9 For example under section 63 of the Trustee Act 1925 (NSW), section 96 of the Trusts Act 1973 (Qld) or section 92 of the Trustees Act 1962 (WA)

10 The purpose of judicial advice is merely to seek the Court's view on whether it is within a trustee's power to put to members a proposal which involves amending the trust's constitution to provide for a disposal of members' interests to an acquirer.

	Whether any extension of the scheme provisions should be limited to listed MISs? The Committee considers that unlisted MISs are arguably in greater need of a formal Court-sanctioned scheme of arrangement. Takeovers Panel Guidance Note 15 ameliorates a number of the less desirable features of a listed trust scheme by, for example, stipulating a certain standard of disclosure, the appointment of an independent expert and the application of voting exclusions at pain of a declaration of unacceptable circumstances[11]. The Takeovers Panel, however has no jurisdiction over unlisted schemes and therefore these protective mechanisms are not automatically available to members of such schemes.
Whether, and if so in what manner, the scheme provisions might be simplified for mergers within wholly owned corporate groups (section 6.3)	The Committee supports the proposal to simplify section 413 schemes through a short form merger process that would dispense with shareholder involvement and reduce the role of the Court, as outlined in section 6.3 of the Discussion Paper. The Committee notes that a potential difficulty associated with section 413 schemes is the impact on third party rights and the position of creditors. The Committee supports a process which involves directors approving the merger and the requirement that directors to sign a certificate that they are satisfied that the merger will not materially affect the company's ability to pay its creditors and considers that these mechanisms adequately address the third party rights and creditor protection issues.
Whether, and if so in what manner, the scheme provisions could be adapted to accommodate the possibility of schemes being initiated otherwise than by the target company (section 6.4)	The Committee is strongly opposed to any proposal which would facilitate 'hostile' schemes. Part of the justification for allowing takeovers to be conducted through the scheme mechanism is that such a takeover must attract the support and participation of the scheme company's board. The Committee does not think it appropriate for a single, unified explanatory statement to be prepared in relation to a scheme which was not supported by the board of the scheme company. The Committee also notes that a 'hostile' scheme process has the potential to lead to lower bid premiums by removing pressure on bidders to propose a scheme on sufficiently attractive terms to encourage directors to put the scheme to shareholders.

6 Other aspects of members' schemes that may benefit from further consideration

Feedback sought	Committee's comments
Section 1.5.1 (p11) - question of the extent to which creditors' schemes for solvent or	The Committee considers that creditors' schemes should be retained. However if creditors' schemes are not be retained, provision should be made to bind holders of a scheme company's convertible notes by a procedure similar to

[11] The Takeovers Panel considers that trust schemes come within its powers under Part 6.10 of the Corporations Act as they affect the control of the target trust and involve acquisitions of substantial interests that come within section 657A(2) (GN 15.14).

insolvent companies still perform a useful function, and on possible changes to facilitate or better regulate those schemes	(or part of) a members' scheme of arrangement. If creditors' schemes are to be retained, the Committee refers to its previous suggestion that the Court be given power to quantify creditors' claims, to fix voting entitlements.
Section 1.5.2 (p11) - whether section 414 still performs a useful function not performed by schemes, bids or other means to effect a change of control.	In the Committee's view, the section 414 process is rarely used, is poor policy and badly drafted and should be repealed as recommended by CASAC in its 1996 Report on Compulsory Acquisition and Buyouts and by the Simplification Task Force in its Takeovers proposal.[12] The only defensible reason for retaining it in its present form was that the section 414 procedure was available for compulsory acquisition after bids to which Chapter 6 did not apply. This was removed when Chapters 6 and 6A made provision for bids to be made in order to satisfy the requirements of section 661A, even where section 606 did not apply to the acquisition of shares under the bid.
Transfer schemes / cancellation schemes	The Discussion Paper notes that transfer schemes are now much more common than cancellation schemes. The Committee notes that the preference for transfer schemes is not solely driven by tax considerations. The other significant issue is the requirement in section 256C(2) of the Corporations Act that a selective reduction of capital (which is part of a cancellation scheme) be approved by special resolution passed at a general meeting of the company, with no votes being cast in favour of the resolution by any person 'who is to receive consideration as part of the reduction'. The issue that arises here is that if the consideration which target shareholders are receiving under the scheme is regarded as 'consideration as part of the reduction', any shareholder can vote against the transaction, but no shareholder (other than the intending acquirer with only a negligible holding) can vote in favour, so that the resolution can never be passed. In *Tiger Investments*[13], Santow J gave some tentative support on a first Court hearing to an argument that the consideration being provided under the cancellation scheme is truly consideration as part of the scheme and not consideration as part of the reduction, but the issue is far from settled. This could be simply dealt with by giving ASIC the power to amend Part 2.J1 of the Act to allow all shareholders other than the intending acquirer to vote at the general meeting where all target shareholders are getting the benefit of the consideration in the same way. This is similar to the modification granted by ASIC in relation to section 611 item 7 on a trust scheme where all target shareholders would otherwise be prevented from voting on the resolution.

[12] The Lavarch Committee recommended in 1991 that section 414 be brought into line with the predecessor of section 661A: Recommendation 10 of *Corporate Practices and the Rights of Shareholders* Report of the House of Representatives Standing Committee on Legal and Constitutional Affairs, November 1991.

[13] *Tiger Investment Company Ltd and the Corporations Law* [1999] NSWSC 1290, New South Wales Supreme Court, Santow J, 23 December 1999.

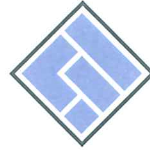
Annexure - Recommended disclosure changes

Part 5.1	Chapter 6	Recommendation
Prospectus Information		
No specific rule. The prospectus provisions are disapplied by subsection 708(17), but there is no corresponding exclusion of the PDS provisions (except by class order) and no specific requirement to provide equivalent information.	Sections 710 – 713 or 1013C – 1013FA (applied to scrip bids by paragraph 636(1)(g) or (ga)): all the information that investors and their advisors would reasonably require to make an informed assessment of the securities offered as consideration and of the issuer of those securities.[14]	Adopt paragraphs 636(1)(g) and (ga) for schemes involving scrip consideration, retain subsection 708(17) and adopt a corresponding exclusion of the PDS provisions.
Directors Interests		
Clause 8301: Directors' intentions and recommendations.	Subsection 638(3): directors' recommendations, but not intentions.	Retain but incorporate into Part 5.1.
Independent Expert's Report		
Clauses 8303, 8304 and 8306: independent expert's report, if acquirer has 30% or more entitlement[15] in scheme company. There are no provisions corresponding with subsections 648A(2) and (3) on independence.	Section 640 and subsection 648A(1): independent expert's report, if bidder has 30% or more voting power in target.	Retain, but incorporate into Part 5.1 and adopt 30% test from section 640 and subsections 648A(2) and (3).
Expert's Criterion		
Clause 8305: ASIC consent to profit forecast or asset revaluation in independent expert's report.[16]	No rule.	Repeal: the corresponding requirement for bidder's and target's statements was removed in 1991 and is not missed.
Itemised Disclosure		
Clause 8302: • directors' interests in both companies; • trading prices for scheme company securities; • update to accounts.	No rule, but trading prices and update to accounts covered by general disclosure test.	• directors' interests - retain but incorporate into Part 5.1 • trading prices - repeal as redundant • accounts - repeal as redundant.
Clause 8307: Formula for number of securities to be issued to each scheme member	Subsection 633(1) item 1 requirement to set out terms of offer.	Repeal as redundant (this must be set out in scheme itself).
Clauses 8308 and 8309: Trading prices for securities to be issued to scheme members.	No specific rule.	Repeal as redundant.
Clause 8310: Intentions of directors of scheme company regarding its future.	Paragraph 636(1)(c) or (d): intentions of bidder regarding future of target.	Incorporate into Part 5.1 and amend to refer to acquirer's intentions, like section 636 (in a control transaction context).

[14] This is based on subsection 710(1): different requirements apply if section 712 or 713 is relevant.

[15] Clause 8102 defines "entitlement" to mean an ability to exercise a percentage of the total votes that could be exercised by members. This uses elements of the current concept of voting power, but differs from both that concept and the concept of entitlement used in the Corporations Act.

[16] This applies only to the report, not to the body of the explanatory statement.



BELINDA GIBSON
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10 October 2008

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
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SYDNEY NSW 2001

By email: john.kluver@camac.gov.au

Dear Mr Kluver,

ASIC's response to the *Members' Schemes of Arrangement Discussion Paper*

We would like to thank the Corporations and Markets Advisory Committee for giving ASIC the opportunity to provide feedback regarding the *Members' Schemes of Arrangement Discussion Paper* (Discussion Paper). This letters sets out ASIC's response to the proposals in the paper.

Proposals regarding harmonisation of the scheme provisions with Chapter 6

Whilst we agree with the concept of harmonising the regimes governing schemes involving changes of control and takeover bids, we do not support the approach adopted in the Discussion Paper.

This is because the proposals in the Discussion Paper do not achieve harmonisation of the two regimes. They only address some areas of inconsistency between the two regimes. Importantly, the proposals do not address:

- the absence in Chapter 5.1 of any important shareholder protections in Chapter 6, such as the prohibition on discriminatory conditions (section 627), the four month minimum price rule (section 621(3)), the prohibition on the provision of collateral benefits (section 623), and the automatic offer increase provision (section 651A); and

- the role of the Takeovers Panel in schemes.

It is preferable that any harmonisation of the two regimes would result, as far as possible, in a single regulatory regime governing both schemes involving a change of control and takeover bids (for example, by including these schemes in Chapter 6). The

regime should only differentiate between the two where necessary to recognise the inherent differences between schemes and bids (such as the collective as opposed to the individual decision making).

ASIC in particular is concerned with the proposals regarding section 411(17). Given the "friendly" nature of most schemes, shareholders of companies subject to schemes do not get the benefit of the checks and balances imposed on bidders by targets in a takeover bid. In providing the 'no objection' letter to the court, ASIC plays an important gatekeeper role, the removal of which would be of significant detriment to shareholders. In particular we believe that it is important for ASIC to maintain its practice of providing the final 'no objection' letter at the second court hearing rather than the first court hearing. This is because:

(a) it is not unusual for material developments to arise in the month between the court hearings that may require further action such as disclosure by the company conducting the scheme; and

(b) our practice ensures that any objections raised by shareholders after the first hearing can be taken into account by ASIC and the court.(Courts have held that they are not required to look at the issue of whether a scheme has the purpose of avoiding Ch 6 provisions if we have provided a no-objection statement under s411(17)(b)).

Other proposals in the Discussion Paper

ASIC supports the following proposals in the Discussion Paper which address what we recognise as problems arising from existing deficiencies with the scheme provisions:

1. Giving the court the power to make a binding determination as to classes of members at the first hearing and a 'curative power' at the second hearing to approve a scheme where the classes are later found to have been wrongly constituted (section 4.1).

2. Improving disclosure of scheme information to shareholders (section 3.1). ASIC agrees with the introduction of a 'clear, concise and effective' requirement for the scheme's explanatory statement.

3. Extending the schemes provisions to listed managed investment schemes (section 6.2.1) and unlisted managed investment schemes (6.2.2).

If you wish to discuss these issues further at this stage, please contact Suneeta Sidhu on (02) 9911 2314 or by email (suneeta.sidhu@asic.gov.au).

Yours sincerely

Belinda Gibson
Commissioner

10 October 2008

Mr John Kluver
Executive Director
Corporations and Markets Advisory Council

Dear Mr Kluver

Re: Members' Schemes of Arrangement Discussion Paper

Finsia (the Financial Services Institute of Australasia) is a professional association representing more than 20,000 individuals working across the spectrum of the financial services industry in Australia and New Zealand. Finsia welcomes the opportunity to provide a submission on the Corporations and Markets Advisory Committee's *Members' schemes of arrangements Discussion Paper* released in June 2008.

By way of background, in April 2006, Finsia published a Takeovers Package Discussion Paper which considered, among other things, removing the inconsistencies between the regulation of schemes of arrangements and takeovers. In August 2006, Finsia published a Report on the Consultation to the Takeovers Package, which included a recommendation that the Government consult further on the removal of inconsistencies between the regulation of schemes of arrangement and takeovers. The relevant sections on removing the inconsistency between the regulation of schemes of arrangement and takeovers are extracted in this submission.

Finsia notes that paragraph 1.2.2 of CAMAC's Discussion Paper provides that '[it] 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'.

Finsia commends CAMAC for the detailed discussion (chapter 2) on the different legal treatment and procedural mechanisms that underpin schemes of arrangement in comparison with takeovers. However, Finsia believes there is significant scope for 'regulatory arbitrage' in effecting change of control by scheme of arrangement in situations that would ordinarily be handled by takeovers. The policy rationale, backed by economic analysis, for maintaining two mechanisms for achieving similar results, should be appropriately canvassed.

Also in this context and in light of Finsia's previous work in the area, a detailed consideration of the merits in providing the Takeovers Panel with jurisdiction to hear disputes involving schemes of arrangement would be timely.

Yours sincerely

Dr Martin Fahy F Fin
Chief Executive Officer'

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Appendix 1: Extract from Finsia's Takeovers Package, released April 2006

2.5 Removing the inconsistencies between the regulation of schemes of arrangement and takeovers

Background to Finsia's views

The Corporations Act essentially allows the acquisition of control of a public company to be achieved in one of two ways:

- **A person making a takeover offer for a target company, pursuant to Chapter 6 of the Corporations Act; or**
- **A target company entering into a scheme of arrangement, pursuant to Chapter 5 of the Corporations Act.**

Finsia is concerned that over time, market practice, together with a pattern of judicial decisions, has led to a two-tiered regulatory framework for acquisitions of public companies. This framework permits a person who is seeking to gain control of a public company to carry out "regulatory arbitrage"; in other words, to choose between legislative approaches to the advantage of the bidder without regard to the rights and entitlements of shareholders.

In particular, Finsia believes that the current usage of schemes of arrangements, under the laws that govern them, has resulted in shareholders being deprived of the protection, which legislators intended they should have when takeover laws were formulated.

Schemes of arrangement derived from traditional English law, and the Australian law (section 411) remains similar to the United Kingdom provisions. The law was developed before takeovers, as they are now understood, had developed; indeed the language doesn't suggest that the law's authors contemplated their current usage (section 411 refers to where "a compromise or arrangement is proposed between a company and its creditors or a company and its members").

Notwithstanding the law's derivation or intended purpose, schemes of arrangement have become a common way of effecting a change-of-control transaction. In the last 5 years, nearly 40% of all large (greater than $1billion) change-of-control transactions have been carried out as schemes of arrangement.

Importantly, the nature of schemes of arrangement has changed markedly. Until relatively recently, schemes of arrangement were used predominantly in the circumstances of:

- **Complex transactions which couldn't be achieved by way of takeover; and**
- **'Agreed mergers', typically between companies of similar size, and often with lower premiums than hostile or contested takeovers.**

However, more recently, change-of-control transactions in Australia have tended towards the American model, where transactions that are 'hostile' or at least 'unsolicited' are achieved by the potential bidder putting the target into a 'bear hug'. In a 'bear hug' the bidder induces the target to agree to recommend to shareholders the company's acquisition with the sanction that if the target board doesn't recommend the offer, the board's refusal will be made public and its decision will be subject to the public scrutiny of shareholders and market commentators. Boards' sensitivity to public pressure has been heightened by much greater shareholder activism and higher standards of corporate governance and directors' duties.

The result of this trend has been that change-of-control transactions, which previously would have been effected as takeovers, can now be achieved by schemes of arrangement.

In summary, a scheme of arrangement (a legal mechanism never intended for change-of-control transactions in the first place) has developed from being a method of achieving a 'true merger' (or a complex reconstruction) into a viable alternative for a Chapter 6 takeover.

It should be noted that legislators recognised the problems inherent in the potential duplication of takeover laws by inserting sub-section 411(17) into section 411. This sub-section requires that a court cannot approve a scheme of arrangement unless:

- it is satisfied that the compromise or arrangement has not been proposed for the purpose of enabling any person to avoid the operation of any of the provisions of Chapter 6, or
- ASIC provides a no-objection statement.

This sub-section has been rendered largely ineffective by successive court decisions, and ASIC's current practice is now to issue no-objection statements routinely, subject to it being satisfied that the Eggleston Principles are being broadly met by the scheme of arrangement.

What problems in the law is Finsia seeking to address?

As mentioned above, there are now effectively two separate mechanisms under the Corporations Act for a change-of-control transaction to be effected — a Chapter 5 Scheme of arrangement or a Chapter 6 Takeover.

While Finsia is of the view that it is necessary for both schemes of arrangement and takeovers to be available for change-of-control transactions, the present regime should be revised so that significant anomalies between the approaches and the availability of 'regulatory arbitrage' (that is, the choice for bidders between the two options based on the best regulatory outcome) can be removed from the law.

The main anomalies between the two approaches are set out below.

Shareholders participating in Chapter 5 schemes of arrangement are not afforded a number of the protections contained in Chapter 6. These include:

- the prohibition on discriminatory conditions (section 627),
- the four month minimum price rule (section 621(3)),
- the prohibition on the provision of collateral benefits (section 623), and
- the automatic offer increase provision (section 651A, which automatically increases an offer to the level of cash purchases made outside the offer, if the price of these purchases is higher than the offer).

While the circumstances where an expert's report is required (where the bidder holds more than 30% of the target or where there are common directors between the bidder and the target) are similar as between takeovers and schemes of arrangement, the prescribed test to be applied by the expert is different. In a takeover, the expert must determine whether the offer is 'fair and reasonable', whereas in a scheme of arrangement, the expert must determine whether the offer is 'in the best interest' of the shareholders.

While market participants have sought to resolve the meaning of 'in the best interest' relative to 'fair and reasonable', Finsia believes that there remains a lack of clarity between the terms and a strong likelihood of shareholder confusion as to what the two terms mean.

The provisions relating to compulsory acquisition for takeovers (ie. the levels of acceptance which lead to the takeover becoming binding on all shareholders) and the approval levels for schemes of arrangement (which also lead to the terms of the scheme becoming binding on all shareholders) are also significantly different.

In essence, a bidder can achieve compulsory acquisition in a Chapter 6 takeover by:

- If the bidder starts the offer with less than 60% of the target, achieving a holding of the target of 90%; or

- **If the bidder starts the offer with more than 60% of the target, gaining acceptances in relation to at least 75% of shares under offer.**

By contrast, a scheme of arrangement becomes effective if 75% of shares voted at the meeting are voted in favour of the scheme, and more than 50% of shareholders by number vote in favour of the scheme ("50% head count test"). Importantly, these thresholds relate only to shares voted and shareholders that attend the shareholder meeting, either in person or by proxy.

The effect of these provisions is that the compulsory acquisition threshold is generally much lower for schemes of arrangement than it is for takeovers. In Finsia's view, this difference is difficult to justify; presumably, this matter was considered carefully when the takeover threshold was set, given that compulsory acquisition deals with the important principle of forcible divestment.

Clearly, there are situations where forcible divestment involves significant hardship for a shareholder and can only be justified where an overwhelming majority support the transaction, and the greater good is served by permitting the bidder to force completion. In these circumstances, Finsia believes that the significant difference between the thresholds for takeovers and schemes (given that, as argued above, these two methodologies are effectively alternative approaches to achieve the same outcome) is a significant and unjustifiable anomaly.

Notwithstanding the specific regulatory differences between Chapter 5 schemes of arrangement and Chapter 6 takeovers discussed above, the primary difference is that the underpinnings of takeover law — the Eggleston Principles — are absent from the regulation of schemes.

Finsia believes that the Eggleston Principles, together with the concept that takeovers should take place in an "efficient, competitive and informed market" form the best basis for all change-of-control transactions to take place. It is notable, in prescribing the concepts for Chapter 6 takeovers (section 602), the law provides that the purposes of Chapter 6 are to ensure that these principles apply to the acquisition of control in relation to widely-held companies.

While ASIC, through Policy Statement 60, seeks to incorporate the Eggleston Principles into schemes of arrangement by making compliance with the principles a condition of it granting a section 411(17) no-objection letter, section 411(17) does not make the granting of such a letter a pre-condition for court approval of a scheme. Accordingly, the current law does not require that the Eggleston Principles apply to schemes of arrangement, and indeed the courts have stated that the Eggleston Principles may not always be applicable to schemes.

In summary, Finsia is strongly of the view that the current situation where schemes of arrangement are being used as an alternative to takeovers for change-of-control transactions is anomalous for the following reasons:

- **There is no application of the Eggleston Principles to schemes;**
- **There is a lack of shareholder protection provisions in Chapter 5 schemes, and**
- **There are differing thresholds for compulsory acquisition from dissenting minorities.**

These distinctions do not serve any useful purpose in an efficient and competitive market for corporate control.

Finsia notes that the courts, assisted by the ASIC section 411(17) opinion, administer schemes of arrangement, whereas takeovers are administered by ASIC and the Takeovers Panel.

In the case of a scheme of arrangement, there are two compulsory court hearings during the course of the scheme. In the case of a takeover, the Takeovers Panel plays a role only where a party makes a complaint. There is a range of views on the appropriate jurisdiction to administer schemes and we would be pleased to participate in any discussion on the respective merits of the courts and the Takeovers Panel, noting that the Takeovers Panel has developed into an effective and expert forum for deliberating on change of control transactions.

What is Finsia's proposed approach?

Finsia is of the view that the anomalous laws pertaining to takeovers and schemes of arrangement cannot be justified in the context of an efficient and competitive market. However, while the case for reform in this area can be made strongly with relative ease, the method of achieving reform is more problematic.

In Finsia's view, the primary issue to consider is: should schemes of arrangement remain as an alternative methodology for effectively achieving a takeover, or should they be restricted (as the wording of section 411(17) suggests was the intention of the legislature) to transactions not achievable by way of takeover?

Finsia's view is that it would be preferable to restrict schemes of arrangement to:

- **Complex transactions which cannot reasonably be effected by way of Chapter 6 takeover; and**
- **True 'mergers of equals', defined broadly as mergers by way of scrip for scrip, or predominately scrip for scrip, between companies of similar size and where control of the new company going forward is shared between the merger partners.**

If this approach were to be taken, it could be achieved by a new section 411(17), which could incorporate the above concepts.

Finsia recommendations

Irrespective of whether the role of schemes of arrangement is restricted as suggested, Finsia believes that the anomalies in the law need to be removed.

Accordingly, Finsia recommends that:

1. **The Eggleston Principles be formally included in Chapter 5 as a basis for all schemes of arrangements where they constitute change-of-control transactions. Finsia believes this will provide a consistent regulatory framework for all change-of-control transactions.**

2. **Chapter 5 be reviewed thoroughly, such as to incorporate all relevant disclosure requirements and protections that are currently provided to shareholders in Chapter 6. Finsia believes this would reduce "regulatory arbitrage" between takeovers and schemes. Part of the reason for reforming the provisions is to ensure a single prescribed test for independent experts' reports is applied. Finsia considers that "fair and reasonable" a concept provides sufficient flexibility to allow quantitative and qualitative assessment for all transaction types.**

3. **The thresholds for effecting a scheme of arrangement be brought into line with the compulsory acquisition thresholds in Chapter 6. Finsia notes that this proposal would still be different from takeovers in that it would apply only to shares voted at the meeting (as distinct from a Chapter 6 compulsory acquisition, which is based on the target company's entire capital). However, Finsia believes that this proposal would reduce considerably the advantage that schemes may have over takeovers, in relation to forcible divestment of dissenting minorities' shares. Our proposal is that the scheme resolution would fail if more than 10% of the shares on issue in a relevant class of shares are voted against the resolution.**

4. **The present "50% head count" test for approval of schemes of arrangement is removed (at odds with fundamental notion of corporate democracy, i.e. one vote per share).**

Finsia recognises that there is debate across industry concerning schemes of arrangement and some market participants favour their retention as 'takeover alternatives'. Accordingly, Finsia believes that it is appropriate for the Government to consider public perspectives on this matter, perhaps through the Parliamentary committee process.

Appendix 2: Schemes of arrangement reform

(Adapted from Finsia presentation to Business Regulation Advisory Group (BRAG) meeting, 9 June 2007).

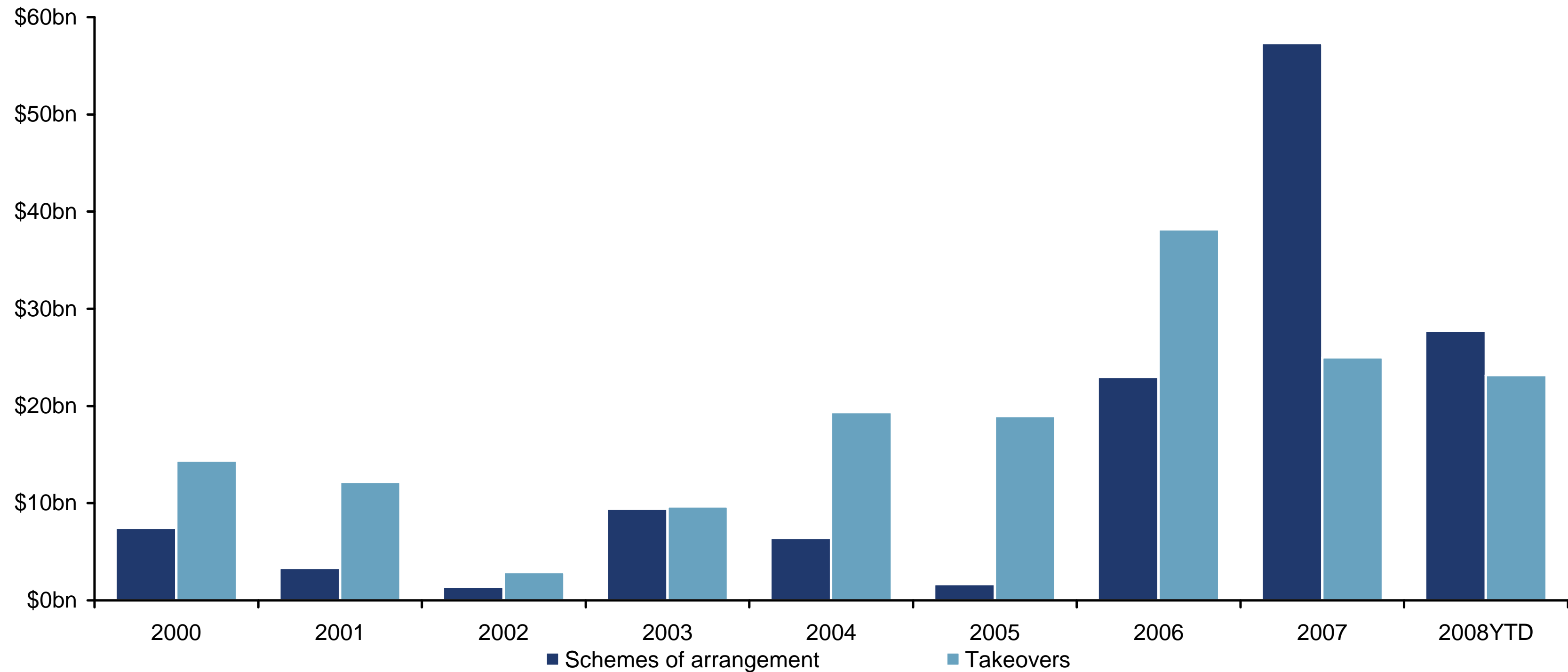
Issues

- Source of law:
  - Part 5.1, *Corporations Act 2001*
- Reasons for reform:
  - The framework permits a person who is seeking to gain control of a public company to carry out "regulatory arbitrage"
  - Finsia believes that the current usage of schemes of arrangement has resulted in shareholders being deprived of the protection which legislators intended they should have when takeover laws were formulated
  - As courts have supervisory jurisdiction in schemes of arrangement, different approaches are taken by different judges leading to a lack of certainty
- Recommended changes:
  - Review of law to remove anomalies and reduce "regulatory arbitrage"
  - Schemes of arrangement should not be available as an alternative methodology for achieving a takeover, or should be restricted (as the wording of section 411(17) suggests was the intention of the legislature) to transactions not achievable by way of takeover
  - Consideration should be given to broadening the role of the Takeovers Panel to replace the role of the Court in schemes of arrangement to ensure consistency with the Eggleston principles and to ensure that disputes are resolved by experts

Discrepancies between schemes and takeovers

Issue	Scheme	Takeover
Voting threshold	■ 75% of shares voted ■ 50% of shareholders voting	■ 90% of all shares
Independent expert test	■ In shareholders' best interests	■ Fair & reasonable
Acquisition of shares	■ Scheme can be done at any price	■ Offer must be at minimum value of the highest price paid for shares within 4 months
Role of regulators and court	■ Court: supervisory ■ ASIC: approval of documentation	■ Takeovers Panel is first forum for dispute resolution ■ ASIC: review of documentation
Pre-bid stakes	■ Likely to form separate class and be ineligible to vote	■ Counts toward meeting threshold
Eggleston principles	■ Included only by ASIC policy statement 60	■ Codified in legislation
"Competitive market principle"	■ Included only by ASIC policy statement 60	■ Codified in legislation

The rise and rise of schemes of arrangement (updated in June 2008)



Source: GSJBW research, public company filings

Methodology: All announced public market M&A transactions greater than US$250m since 1 January 2000 excluding BHP / Rio Tinto which has been removed given it is still being undertaken

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15 October 2008

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
GPO Box 3967
SYDNEY NSW 2001 email: john.kluver@camac.gov.au

Dear Mr Kluver

Re: Members' Schemes of Arrangement – Discussion Paper

1. Introduction

I refer to the Discussion Paper published June 2008 entitled 'Members' Schemes of Arrangement (**Discussion Paper**).

The Discussion Paper has been reviewed by the Law Society's Business Law Committee (**Committee**) and the Law Society welcomes the opportunity to make a submission.

Set out below are certain views expressed by the Committee. As the Discussion Paper has not been considered by the Council of the Law Society, the views expressed are those of the Committee alone.

2. Information to Shareholders

2.1 The Committee supports the view that the specific disclosure obligations, set out in Corporations Regulations, Schedule 8, Part 3, should not be omitted but should be revised to be more consistent with the required content of bid documents.

2.2 The Committee supports the cost-reduction proposals set out in paragraph 3.1.2 of the Discussion Paper on the assumption that the full Explanatory Statement would always be made available to a shareholder upon request.

2.3 The Committee supports the view that the scheme provisions should incorporate a supplementary disclosure regime similar to that for a bid.

2.4 For the reasons set out in section 3.3 of the Discussion Paper, the Committee supports the view that information supplied in an Explanatory Statement under a scheme should be subject to a stand-alone liability and defence regime that is modelled on that applicable to bids.

2.5 The Committee supports the view that for an independent expert's report on a scheme, the expert should apply the 'fair and reasonable' test which applies to bids rather than the current 'best interests' test.

3. Voting on Schemes

3.1 The Committee supports the view that the court be given an express power, at the first court hearing, to make a binding determination on the composition of classes. As there is usually a considerable period of time between the initial announcement and the first court hearing, it would be possible for shareholders to be given advance notification (i.e. 14 days) of any application to the first court hearing for a binding determination on class composition.

3.2 The Committee also supports the proposal that the court be given an express 'curative' power at the second court hearing to approve a scheme if the classes have been wrongly constituted.

3.3 For clarification, the Committee supports the proposal that the scheme provisions specifically state that any votes passed in favour of the scheme by an intending controller should be disregarded.

3.4 The Committee agrees with the Law Council that the headcount test for shareholders in schemes should be abolished for the reasons set out in section 4.2.4 of the Discussion Paper under the heading: 'Option 4: Dispense with the headcount test'.

3.5 The Committee supports the view that for a scheme involving a company limited by guarantee there should be one voting test being approval of 75% of the members who vote on the resolution.

4. Regulatory and Judicial Powers

4.1 The Committee supports the view that:

(a) ASIC's dispensing and consent powers with respect to schemes do not need to be expanded; and

(b) there should be a short-form merger procedure for wholly-owned corporate groups that would not require shareholder approval.

4.2 For the reasons set out in section 5.2.4 of the Discussion Paper, the Committee supports the view that section 411(17) should be amended to include the Eggleston principles and to require further statements which would facilitate consideration of the scheme and its documentation.

5. Extension and Simplification of Schemes

5.1 The Committee supports the view that optionholders and noteholders should participate in members' schemes and be treated as separate classes from holders of issued shares (with different exercise prices and expiry dates being ignored). The headcount test should not apply.

5.2 The scheme provisions should be amended to cover listed managed schemes in order to better protect the interest of unitholders, including the overriding of any equivalent provisions in the constituent documents of a managed scheme.

5.3 The Committee supports the view that there should be a short-form merger procedure as described in section 6.3 of the Discussion Paper for wholly-owned corporate groups.

5.4 The Committee supports the view that scheme provisions should not be adapted to facilitate their use where a target board opposes a scheme and is unwilling to put the proposal to shareholders. It is not practicable to make such amendments.

6. Further Advice

The Committee is interested to provide further advice to CAMAC.

If any further information is required in relation to the submission, please contact Petra Zlatevska, Executive Member of the Business Law Committee by phone on (02) 9926 0106, or by email to pzlatevska@lawsocnsw.asn.au .

Yours sincerely

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Association of Building Societies and Credit Unions

Abacus
Australian Mutuals

31 October 2008

Mr John Kluver
Executive Director
Corporations and Markets Advisory Committee
Sydney NSW 2001
By email: john.kluver@camac.gov.au

Dear Mr Kluver

Members' Schemes of Arrangement

Thank you for the opportunity to comment on CAMAC's June 2008 Discussion Paper *Members' Schemes of Arrangement.*

Abacus – Australian Mutuals is the industry body for credit unions, mutual building societies and friendly societies. For more information on Abacus and our 167 member organisations go to www.abacus.org.au.

Credit unions are generally companies limited by shares. Mutual building societies are generally companies limited by shares and guarantee. Most friendly societies are companies limited by guarantee or by shares and guarantee.

The key common feature of the overwhelming majority of Abacus members is that they are organised on the basis of the principles of mutuality, with each company member or shareholder having one vote. In companies where shares have been issued, such as credit unions, the shares are not transferable and each member has an identical shareholding of either one or five shares. Shares issued are more in the nature of a ticket of membership than a financial investment, although other shares issued may have elements of both characteristics.

Mutual companies are focused on member service rather than by a desire to achieve a financial return through the generation of profit on either capital or income account in relation to their shares.

Members of mutual companies cannot be equated to shareholders in non-mutual companies. Credit unions, mutual building societies and friendly societies were transferred from various State legislative regimes to the Corporations Act regime in 1999 through amendments that inserted a Schedule 4 to the Corporations Act.

The Explanatory Memorandum to the Financial Sector Reform (Amendments & Transitional Provisions) Bill No.1 1999 recognised that members of transferring financial institutions are, by and large, likely to be members in order to obtain financial services from the entities concerned.

"In that sense, they are akin to consumers of financial services rather than investors in financial services providers," the Explanatory Memorandum said.

Abacus members have an interest perhaps greater than ordinary listed companies in the operation of the schemes' provisions. The procedure provided in Section 411 for schemes of arrangement is typically the only means for mergers and other important corporate reorganisations to be achieved, other than by transfers of business.

Abacus members are generally not companies to which Chapter 6 of the Corporations Act easily applies.

Mergers between credit union members of Abacus regularly take place as transfers of business under the *Financial Sector (Business Transfer and Group Restructure) Act 1999* (Business Transfer Act).

However, if features of membership other than just a simple transfer of business engagements is required, other elements of the Corporations Act (eg the class rights provisions of Part 2F.2) can be attracted. In addition the whole may also require a scheme of arrangement.

If the arrangement is a demutualisation as defined in clause 29(1) of Schedule 4 of the Corporations Act, further disclosure is required (see clauses 29 – 33), a specific unconscionable conduct regime applies (clause 34), and the Court is given additional powers (clause 35).

Abacus provides the following comments on matters raised in the Discussion Paper.

Information to shareholders

Possible changes to facilitate effective disclosure of scheme information to shareholders, including in relation to the content and method of disclosure (Section 3.1)

The statute should indicate that the explanatory statement should include all information relevant to the question whether a reasonable person who is a member of the company or the relevant class should vote in favour of, or against, the matter being considered. This statement would focus disclosure on the constituency to consider the issue and the different considerations that each constituency might consider to be relevant. This would be equivalent to the general disclosure test in paragraph 636(1)(m) in takeovers, s710 in prospectuses or s1013E in PDSs.

Not only are prescriptive lists of disclosure issues no longer favoured in the legislation, but any attempt to be more prescriptive about disclosure would tend to focus attention on issues that arise in the circumstances of particular schemes and provide little guidance in relation to other more innovative schemes. This might suggest that the more innovative schemes are not permitted, which would reduce the utility of the scheme of arrangement facility.

There is, however, significant benefit in ensuring that other disclosure regimes attracted by a scheme proposal are harmonised with the disclosure in the explanatory statement.

For Abacus members that would include the demutualisation disclosures prescribed in Schedule 4 and the disclosures required for a business transfer under the Business Transfer Act. It is submitted that the scheme provisions, being the most general, should direct the court only to convene meetings on the basis of an explanatory statement where the court is satisfied that the explanatory statement addresses any specific disclosure regime applicable in relation to any element of the scheme. The legislation could then draw the attention of the Court to appropriate regimes that might be attracted, for example:

- if securities are to be issued – sections 710 – 713
- if other financial products are to be issued – sections 1013D – 1013K
- if shares are to be bought-back – sections 257D(2) and 257G
- if financial assistance is to be given in connection with a share acquisition – section 260B(4)
- if capital is to be reduced – section 250C(4)
- if the company is one to which Schedule 4 applies – clauses 29 -33
- if the company is a Financial Sector company and there is a transfer of business involved in the scheme – the Business Transfer Act and the Transfer Rules.

The Court should be satisfied that the disclosure addresses all the standards applicable to each element of the scheme.

Except if the Court otherwise orders, the proponent of a scheme of arrangement should be obliged to establish an appropriate Internet presence that sets out:

- a version of the current explanatory statement showing all changes to the version of the Explanatory statement shown to the court at the first hearing (initial explanatory statement); and
- a cumulative list of all changes made (and the date of making) to the initial explanatory statement.

Whether there should be greater statutory guidance concerning supplementary disclosures (Section 3.2)

No change to the explanatory statement should be allowed unless it is made at least five business days before the date set for the meeting or the date for the meeting is moved so that it is five business days or more after the date of the change. Otherwise supplemental disclosure should be encouraged based on s643, 644, 724 and 1014E.

Whether the required standard for formulation of an expert's opinion should be more consistent between bids and schemes (Section 3.4)

It is suggested that, consistent with the proposition that schemes of arrangement should be a flexible device allowing companies to deal with a wide range of expected and unexpected contingencies, the test for independent experts' reports should be equally flexible. While the current "best interests of the members" test is flexible, it tends to confuse because it seems to refer to issues of directors' duties rather than matters appropriate for an expert to report on to members.

It is suggested that if the compromise or arrangement involves existing members giving up existing rights, then the test should be equivalent to that contained in section 641. If that is not the case, the test ought to be one which directs the independent expert to compare the value of the existing interest of the relevant members with the benefits offered to them under the scheme. It is not necessary in the end to have a formulation so long as the subject matter for the comparison is clear.

Voting on schemes

The headcount test as it applies to companies limited by guarantee (Section 4.2.5)

As noted in the Discussion Paper, simply eliminating the headcount test would leave these companies without a mechanism for member approval of schemes.

Abacus supports retention of the headcount test for companies limited by guarantee.

Abacus opposes lifting the headcount test for these companies from a simple majority to 75 per cent. The simple majority test provides greater flexibility for schemes that do not involve matters that require a special resolution. An amendment to the company's constitution, a demutualisation, or any other proposal that requires a special resolution would require approval of 75 per cent of members who vote.

As noted in the Discussion Paper, the court has a broad supervisory role in relation to proposed schemes, reflected in the requirement that a scheme, even when approved by members, can be implemented only if also approved by the court.

Extension and simplification of schemes

Could the scheme provisions be adapted to accommodate the possibility of schemes being initiated otherwise than by the target company (Section 6.4)

Abacus does not support adapting the scheme provisions to accommodate "hostile" schemes.

Such a proposal opens the possibility of a mutual company being brought to a commercial standstill by an outside party with no obligations to the company's members.

As the Discussion Paper notes, the current legislation proceeds on the basis that the company will take the responsibility for proposing the scheme. The members are protected by the fiduciary duties of the company's directors as well as the supervisory role of the court.

Unlike a takeover bid for an ordinary listed company, a proposal for a change of control of a mutual company that requires a demutualisation means that the members are being asked two distinct questions:

1. Should we cease to be a mutual company and, if so, how should the company's economic value be allocated to members? and

2. Once I have been allocated transferable shares, should I accept this offer for my ownership stake?

This means that a takeover of a mutual company is necessarily a two-step process whereby members first decide whether or not their membership rights are for sale before deciding whether to accept a particular offer for those rights.

The implementation last year of a new regulatory framework for member registers of credit unions, mutual building societies and friendly societies allows for contact with members while protecting the confidentiality of members' names and addresses. The regulatory framework now better recognises that a mutual company's member register is its customer list.

The framework provides for a new mailing house route where a mutual has not provided a copy of its register to an applicant within 28 days of first application.

Under this new "third party access" step, the following process applies:

- An applicant must certify that its proposed use of the register information is lawful and pay upfront the 'reasonable costs' of contacting members;
- The mutual must make arrangements with a third party service provider (e.g. a mailing house) for contact with members to take place;
- The applicant must provide the material to be communicated to members to the mutual body corporate, which then has 28 days to review and take advice on the proposed communication before submitting it to the third party service provider;
- If the mutual body corporate has reasonable grounds to believe that the person intends to use register information for a purpose or in a way that is unlawful, it can halt the contact arrangements;
- Timeframes apply for providing register details and a best efforts commitment applies for lawful contact with members via the third party service provider.

Please do not hesitate to contact me on 02 6232 6666 to discuss any aspect of this submission.

Yours sincerely,

LUKE LAWLER
Senior Adviser, Policy & Public Affairs