



HERBERT  
SMITH  
FREEHILLS

# **SCHEMES OF ARRANGEMENT IN AUSTRALIA**

**LEGAL GUIDE**





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# Schemes of arrangement in Australia

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## About this booklet

This booklet is intended as a general guide on schemes of arrangement in Australia and how they can be used to gain control of listed or widely held Australian companies.

This booklet, by necessity, only summarises the main features of the law and practice relating to schemes of arrangement. Accordingly, many aspects of the law and practice are not fully described. Obviously, this booklet should not be relied on as a substitute for obtaining specific advice before determining a course of action.

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# 1 Introduction

There are various ways to acquire control of a listed or widely held Australian company. The two most common ways are by 'scheme of arrangement' and by 'takeover bid'.

A **scheme of arrangement** (or scheme) is a statutory procedure between a target company and its shareholders under which a bidder will acquire all of the shares in the target company in exchange for the payment of cash, securities or a mixture of both to target shareholders. This transaction must be approved by target shareholders at a meeting and then by the court. Once these approvals are obtained, the transaction will bind all the target shareholders, whether they voted in favour of the scheme or not. A scheme of arrangement can also be used to effect a wide variety of other transactions, some of which are referred to in this booklet.

By comparison, a **takeover bid** involves the bidder making offers to the shareholders in the target company. If the bidder acquires at least 90% of the shares in the target, the bidder will be entitled to compulsorily acquire any of the outstanding shares in the target.

Change of control transactions are governed by a number of different and overlapping pieces of legislation. The legislation most commonly encountered is discussed in section 8 of this booklet. One of the more important pieces of legislation is the Commonwealth *Corporations Act 2001* (**Corporations Act**) which, in general terms, prohibits a person from acquiring more than 20% of the shares in a listed or widely held Australian company. This is known as the 20% rule. The two main exceptions to this rule are acquisitions by way of scheme of arrangement under Part 5.1 of the Corporations Act and acquisitions by way of takeover bid under Chapter 6 of the Corporations Act.

This booklet focuses on schemes of arrangement.

## 2 What is a scheme of arrangement?

### 2.1 Definition

Schemes of arrangement are most commonly used to effect change of control transactions involving listed or widely held Australian companies. When used for this purpose, a scheme of arrangement involves a statutory procedure between a target company and its shareholders which, if approved by target shareholders and the court, will result in a bidder acquiring all of the shares in the target. In Australia, the term 'merger' is sometimes used to refer to a scheme of arrangement that leads to the acquisition by one company of another company of comparable size.

As the scheme of arrangement procedure is driven by the target, it can only be used to acquire a target on a friendly basis, unlike a takeover bid. In other words, it is generally thought that it is not possible to conduct a hostile scheme.

### 2.2 Types of schemes

There are two types of schemes of arrangement that may be used to effect change of control transactions. These are known as 'transfer schemes' and 'cancellation schemes'.

#### Transfer schemes

Under a transfer scheme, all of the shares in the target (other than any target shares held by the bidder) are transferred to the bidder. In return, the bidder will pay the target shareholders cash, securities or a mixture of both.

Today, most schemes of arrangement are transfer schemes.

#### Cancellation schemes

Under a cancellation scheme, all of the shares in the target (other than the target shares held by the bidder) are cancelled by means of a capital reduction. In return, the bidder will pay the target shareholders cash, securities or a mixture of both.

### 2.3 Trust schemes

It is not possible to acquire a managed investment scheme (such as a unit trust) by way of scheme of arrangement. However, an economically equivalent outcome may be achieved with the use of what is colloquially known as a 'trust scheme'.

A trust scheme can either be in the form of a 'transfer scheme' or a 'redemption scheme'. Under a transfer scheme, the responsible entity for the managed investment scheme transfers all existing units in the managed investment scheme to the bidder. Under a redemption scheme, the responsible entity redeems all units in the managed investment scheme not held by the bidder. In each case, the bidder will pay the target unit holders cash, securities or a mixture of both.

Both types of trust schemes typically require the target unit holders to pass:

- an ordinary resolution to approve the bidder increasing its voting power above the 20% takeover threshold; and
- a special resolution to amend the constitution of the managed investment scheme to empower the responsible entity to take all necessary steps to give effect to the trust scheme.

### 3 What can a scheme of arrangement be used for?

As noted in section 2 of this booklet, schemes of arrangement are most commonly used to effect change of control transactions involving listed or widely held Australian companies. However, schemes of arrangement can also be used to effect a wide variety of other corporate transactions, including:

- demergers;
- reverse takeovers;
- eliminating minority shareholders;
- redomiciliations;
- interposing a non-operating holding company;
- demutualisations;
- reconstructions;
- amalgamations; and
- compromises and other arrangements with creditors (for example, debt for equity restructures).

This booklet focuses on the use of schemes of arrangement to effect change of control transactions.

#### **CASE STUDY — USE OF SCHEMES TO ELIMINATE MINORITY SHAREHOLDERS**

A scheme was used to acquire the outstanding shares of the minority shareholders in BlueFreeway Limited. IPMG Administration Pty Limited held 73.15% of the BlueFreeway shares and agreed to pay a cash sum to acquire all of the outstanding shares.

## 4 Key documents

### 4.1 Confidentiality agreement

The confidentiality agreement is entered into between the prospective bidder and target at the start of discussions. It is designed to protect the secrecy of these discussions, as well as restrict the use of any confidential information that is exchanged between the parties. The confidentiality agreement may also contain standstill provisions which prevent the bidder from acquiring target shares, without the target's consent, for a period of time.

### 4.2 Implementation Deed

The implementation deed is entered into between the bidder and target just before the scheme is announced to the market. The deed will typically contain, among other things:

- the steps that the bidder and target must perform to implement the scheme;
- the conditions to the scheme;
- restrictions on the target's conduct of business before the scheme becomes effective, such as not entering into contracts above a specified threshold or disposing of material assets; and
- deal protection mechanisms (see section 5 for more details).

### 4.3 Scheme booklet

The target is required to send a disclosure document known as the 'scheme booklet' to its shareholders. The scheme booklet must explain the effect of the scheme and contain all the information that is material to a shareholder's decision as to whether to vote in favour of the scheme.

Although the target is primarily responsible for preparing the scheme booklet, the target will require considerable information from the bidder. The level of information required from the bidder will vary depending on whether the consideration it is proposing to pay under the scheme is made up of cash, securities or a mixture of both. If the consideration is (or includes) securities, a prospectus level of disclosure is required.

The scheme booklet will contain a very similar level of disclosure to that which would be found in a bidder's statement and target's statement if the transaction were instead proceeding by way of a takeover bid.

If any material new information arises, or a variation to the terms of the scheme is proposed, after the scheme booklet has been sent to target shareholders, that information or variation will need to be drawn to the specific attention of the shareholders in the form of a supplementary disclosure document. Depending on the circumstances, the bidder and target may also need to discuss, and obtain approval for, the new information or variation (as the case may be) with the court.

In some situations, the date of the shareholder meeting(s) may need to be adjourned to give target shareholders sufficient time to consider the new information or variation (as the case may be).

### 4.4 Independent expert's report

The target company will be required to commission an independent expert's report in

connection with the scheme and provide that report to shareholders in the scheme booklet if:

- the bidder has an interest in 30% or more of the shares in the target company; or
- the bidder and the target company have one or more common directors.

However, the market practice in connection with schemes is for an independent expert's report to be commissioned and provided to shareholders even where such a report is not legally required. In addition, the Australian Securities and Investments Commission (**ASIC**) will expect to see an independent expert's report.

In its report, the independent expert must state its opinion as to whether or not the proposed scheme is fair and reasonable, and in the best interest of target shareholders and the reasons for that opinion.

#### **4.5 Scheme of arrangement itself**

The scheme of arrangement itself is the formal document that records the terms and conditions of the proposed scheme between the target and its shareholders. It is also the document that target shareholders and the court are required to approve.

#### **4.6 Deed poll**

The deed poll contains an undertaking by the bidder, in favour of all target shareholders, to perform its obligations under the scheme including the payment of the scheme consideration to target shareholders if the scheme is approved.

## 5 Deal protection mechanisms

### 5.1 Break fee arrangements

It is common for the bidder and the target to agree to a break fee arrangement in the implementation deed to protect the bidder (and sometimes also the target) against costs that are lost if the scheme is not implemented. Typically, a break fee is an agreed amount (generally not exceeding 1% of the deal value) that becomes payable if certain events occur that prevent the scheme from proceeding. Some common events include the target directors ceasing to recommend the scheme or a rival bidder acquiring control of the target.

#### CASE STUDY — BREAK FEES

In considering the scheme involving the acquisition of The Trust Company Limited, the court asked itself whether the target's potential obligation to pay a 1% break fee was likely to coerce target shareholders into voting in favour of the scheme or to deter potential rival bidders. The court concluded that the break fee would not have such an effect.

### 5.2 'No shop' and 'no talk' arrangements

It is also common for the target to agree to 'no shop' and 'no talk' arrangements in the implementation deed, which prevent the target from soliciting (or 'shopping' for) rival proposals from third parties and negotiating with (or talking to) potential rival bidders. However, 'no talk' arrangements must be expressed as being subject to the fiduciary duties of directors to consider unsolicited rival proposals that may be superior. 'No shop'

arrangements do not need to be subject to such a qualification.

### 5.3 Notification obligation and matching right

The target may also agree in the implementation deed to:

- a notification obligation under which it agrees to promptly notify the bidder if it receives an unsolicited proposal from a rival bidder; and
- a matching right under which it agrees that its directors will not recommend a proposal from a rival bidder unless and until they have given the initial bidder a short period (not exceeding five business days) to match or better that other proposal.

### 5.4 Option and voting agreements

Before the scheme is announced, the bidder may also seek to enter into an option agreement, voting agreement or both with one or more target shareholders.

Under an option agreement, the target shareholder grants the bidder a call option over some or all of their shares.

Under a voting agreement, the target shareholder agrees, in favour of the bidder, to vote in favour of the scheme in respect of some or all of their shares.

Such agreements cannot relate to more than 20% of the target's shares (when aggregated with any other interests the bidder may have in the shares in the target).

Care needs to be taken when drafting option agreements and voting agreements to ensure that the relevant target shareholder is not required to be placed in a separate class for voting purposes or required to have their votes discounted on the grounds of extraneous interests (see section 6.2 below).

### **CASE STUDY — OPTION AGREEMENTS**

In the scheme involving The MAC Services Group Limited, the bidder entered into an option agreement with a shareholder in respect of 19.9% of the target shares. The option was only exercisable if a competing proposal was made for the target and the bidder at least matched that competing proposal. The call option was exercisable for the consideration payable under the matching proposal. The court concluded that being party to the option agreement did not require the relevant shareholder to be placed in a separate class for voting purposes.

### **CASE STUDY — VOTING AGREEMENTS**

In the scheme involving the acquisition of Pulse Health Ltd, the bidder (Healthe Care Australia Pty Ltd) entered into an agreement to acquire certain hospital businesses of Evolution Health Care Partners Pty Ltd during the notice period for the scheme meeting. Evolution was connected to (and assumed for the purposes of the court's analysis, to be an associate of) Sante Capital Investments Nominees Pty Ltd, a 15.9% shareholder in Pulse. Sante Capital gave an undertaking to Healthe Care to vote in favour of the scheme and not dispose of its shares in the absence of a superior proposal. Since the independent expert concluded that there was no "net benefit" to Evolution and / or Sante Capital as a result of the hospital acquisitions voting agreement, the court concluded it was appropriate for Sante Capital to vote in the same class as the other shareholders.

# 6 The scheme of arrangement procedure

## 6.1 Overview

The following key steps need to be carried out in the following order to effect a scheme of arrangement:

- prepare the required scheme documents (see section 4 for the key scheme documents);
- group the target shareholders into 'classes' for voting purposes;
- provide the signed implementation deed and the draft scheme booklet, independent expert's report, scheme of arrangement itself and deed poll (the 'relevant scheme documents') to ASIC for its review and comment;
- apply to the court to convene the shareholder meeting(s) (this is known as the 'first court hearing');
- post the relevant scheme documents to target shareholders;
- hold the shareholder meeting(s);
- if shareholders approve the scheme, apply to the court to have the scheme approved (this is known as the 'final court hearing'); and
- carry out the mechanical steps to implement the scheme.

These steps are discussed in more detail below. For an indicative timetable for a scheme of arrangement see the end of this booklet.

## 6.2 Grouping target shareholders into 'classes' and relevance of extraneous interests

### Importance of classes

Target shareholders must be divided into 'classes' for the purposes of voting on the scheme because, in order for a scheme to be approved by the court, it must first be approved by each class of target shareholders. If there is more than one class, each class will vote on the scheme at a separate shareholder meeting. The shareholder approval threshold (see section 6.6 below) must be satisfied for each class of shareholders.

Grouping target shareholders into the correct classes is a critical process because the court will not have power to approve the scheme if the classes were improperly constituted, even if the improper constitution had no impact on the outcome of the shareholder vote.

### Whose responsibility?

The target company is responsible for grouping the target shareholders into classes. However, the courts are prepared to give a non-binding view on the constitution of classes at the first court hearing, which occurs before the shareholder meeting(s) are convened.

### How to constitute the classes

A class is confined to those shareholders whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest. Classes for

the purposes of voting on a scheme may not necessarily be the same as the classes that the shareholders have been divided into for registration purposes.

There are two important features of the class test.

First, the test focuses on the legal rights (as opposed to interests) of target shareholders. More specifically, it focuses on their existing legal rights against the target company and the new rights they will receive under the scheme. In other words, if shareholders have similar legal rights both before and under the scheme, these shareholders should ordinarily be placed in the same class.

Second, even if particular shareholders have different rights before or under the scheme or both, it is only if the effect of the differences makes it impossible for them to consult with other shareholders that the particular shareholders should be placed in a different class.

Generally, courts are reluctant to allow the unnecessary creation of classes as this has the potential to give a small group of shareholders an effective veto right over the approval of the scheme against the wishes of a larger majority.

### CASE STUDY — MARSHALLING SHAREHOLDERS INTO CLASSES

In the scheme involving Hills Motorway Limited, the court confirmed that the 'cashing out' of certain foreign shareholders who would otherwise have received shares in the bidder did not result in those shareholders forming a separate class for voting purposes. This was because, although their rights were to be treated differently, this treatment did not make it impossible for them to consult with the other shareholders.

### Relevance of extraneous interests

If particular shareholders have an extraneous interest in the outcome of the scheme, this is not, of itself, a reason for placing those shareholders in a separate class. An extraneous interest can be, for example, an extraneous commercial, financial or personal interest such as the receipt of a material collateral benefit from the bidder.

However, a court may have concerns if a significant number of shareholders, or shareholders holding a significant number of shares, have voted in favour of a scheme not because it would benefit them in their capacity as shareholders but because it would benefit them in some other capacity. In such cases, the court may discount or even disregard the votes of such shareholders. That being said, the court is unlikely to exercise this power lightly.

## 6 The scheme of arrangement procedure

### CASE STUDY — EXTRANEOUS INTERESTS

In parallel with the scheme involving the proposed acquisition of Aston Resources by Whitehaven, Whitehaven separately proposed to acquire another company from certain Aston Resources shareholders. The independent expert valued that other company at \$200-\$330 million, whereas Whitehaven was proposing to pay \$393 million for it. The relevant Aston Resources shareholders had an extraneous interest in the outcome of the scheme and would likely have had their votes disregarded by the Court had they not voluntarily decided to abstain from voting on the scheme.

### 6.3 Provide the relevant scheme documents to ASIC

ASIC must be given a reasonable opportunity (generally at least 14 days) to examine the relevant scheme documents and make submissions to the court in relation to the proposed scheme before the first court hearing. ASIC will not make the scheme booklet publicly available until after the first court hearing.

ASIC requires the target to specifically draw to its attention any uncertainties or problematic, complex or novel issues in the relevant scheme documents. If ASIC is satisfied with the content of the relevant scheme documents, it will write a letter to the target confirming this. The target will, in turn, produce this letter to the court at the first court hearing.

ASIC may also attend the court hearings to represent the interests of shareholders where ASIC may be the only party before the court other than the target and the bidder. ASIC will also ensure that any matters relevant to the court's decision are brought to the court's attention before it convenes any shareholder meeting(s) or approves the scheme.

### 6.4 The first court hearing

The target must apply to the court for approval to convene the shareholder meeting(s), which is where the target shareholders will consider and vote on the scheme. If there is more than one class of target shareholders, a separate meeting will be required for each class. This application to the court is known as the 'first court hearing'. ASIC may attend the first court hearing if there are matters that it wants drawn to the court's attention.

In deciding whether to convene the shareholder meeting(s), the court will want to be satisfied that:

- the scheme booklet complies with the disclosure requirements;
- ASIC has had a reasonable opportunity to review, and make submissions to the court in relation to, the scheme and the scheme booklet; and
- the scheme is of such a nature and cast in such terms that, if the required shareholder approval is obtained, the court would be likely to approve the scheme at the final court hearing.

The target must formally register the scheme booklet with ASIC before posting it to target

shareholders. This generally occurs shortly after the court has made orders convening the shareholder meeting(s).

### **CASE STUDY — ASIC'S REFUSAL TO GIVE A LETTER OF NO OBJECTION**

In the scheme involving the acquisition of David Jones Ltd, the bidder, Woolworths Holdings Ltd, also made a simultaneous takeover bid for Country Road Ltd (the bid was conditional on the David Jones scheme becoming effective). ASIC refused to give its usual letter of no objection on the basis that Mr Solomon Lew, who had a 9.89% shareholding in David Jones and an 11.8% shareholding in Country Road, had been given an inducement to vote in favour of the David Jones scheme by the financial benefits he would receive if the Country Road bid proceeded. However, the court nevertheless approved the scheme, finding that the circumstances in this case (including the fact that Mr Lew abstained from voting) adequately mitigated ASIC's concerns.

## **6.5 The notice period**

The target (if listed) is generally required to give 28 days notice of the shareholder meeting(s) to its shareholders. These notices are contained in the scheme booklet.

## **6.6 The shareholder meeting**

A scheme of arrangement will only be binding upon a particular class of shareholders if agreed to by a majority:

- in number of the shareholders in that class, present and voting either in person or by proxy; and
- holding at least 75% of the total number of votes cast by the shareholders in that class, present and voting either in person or by proxy.

If these two thresholds are not satisfied by each class of shareholders, the scheme will fail. However, it should be noted that the court has the power to dispense with the first of these two thresholds in appropriate cases (for example, where there is evidence of share splitting which was intended to manipulate the outcome of the vote).

### **CASE STUDY — VOTER ATTENDANCE AT THE SCHEME MEETING**

In the scheme involving the acquisition of Amcom Telecommunications Ltd, TPG Telecom increased its shareholding to 19.99% and said it would not support the scheme or make a counter proposal. Voter turnout in schemes in Australia generally averages about 62% of issued shares, so a 19.99% blocking stake would generally be expected to almost certainly lead to the scheme failing. Following a campaign by Amcom to encourage Amcom shareholders to send in proxy votes, 88% of the shares on issue were voted at the meeting and the requisite majorities were met to approve the scheme.

## 6 The scheme of arrangement procedure

### 6.7 The final court hearing

#### The need for court approval

Once all necessary shareholder approvals have been obtained, and all other conditions satisfied or waived, the court must still approve the scheme at the final court hearing for it to be binding.

#### Factors relevant to the court's discretion whether to approve a scheme

The court has a general discretion as to whether to approve the scheme. The requirement for court approval is one of the important ways in which minority shareholder interests are protected under a scheme.

Where no successful objection has been made to the scheme, and provided that the court is satisfied that the factors listed below have been fulfilled, a court will generally be willing to approve the scheme. In deciding whether to approve a scheme, the court must satisfy itself that:

- the scheme has been approved by the requisite majority of properly informed target shareholders;
- the majority of shareholders have acted in good faith and not in pursuit of some illegitimate purpose;
- the scheme is sufficiently fair and reasonable that an intelligent and honest person, acting alone in respect of their interests as a shareholder, might approve the scheme; and either:
  - ASIC has issued a letter stating that it has no objection to the scheme (see ASIC no objection letter below); or

- if ASIC does not issue a no objection letter, the scheme has not been proposed for the purpose of any person avoiding the operation of any of the takeover provisions in the Corporations Act (see 'Court's consideration of takeover avoidance issues' below).

#### ASIC no objection letter

ASIC will usually issue a no objection letter if it is satisfied that:

- all material information relating to the proposed scheme has been disclosed to it; and
- the standard of disclosure to, and treatment of, the shareholders is commensurate with the standard that would be required if the transaction had instead been conducted by way of a takeover bid.

Importantly, it is ASIC's policy that neither it nor the law has a preference as to whether change of control transactions are conducted by way of scheme of arrangement or takeover bid.

#### Court's consideration of takeover avoidance issues

In determining whether a scheme has been proposed for the purpose of avoiding any of the takeover provisions in the Corporations Act, the court will consider, among other things, whether there was a legitimate commercial purpose in the scheme proponents choosing to conduct the transaction by way of scheme of arrangement instead of takeover bid. Such purposes may include:

- the particular demands of persons financing the transaction;

- the need for unrestricted access to the target's cash reserves;
- the certainty of obtaining capital gains tax rollover relief; and
- the ability of a scheme to achieve an 'all or nothing' outcome in a set period of time.

As the courts have made it clear that the law has no preference as to whether change of control transactions are conducted by way of scheme of arrangement or takeover bid, the mere decision to proceed by way of a scheme cannot, of itself, be treated as evidence that the scheme was proposed for the purpose of avoiding the operation of any of the takeover provisions.

#### CASE STUDY — TAKEOVER AVOIDANCE

In the scheme involving the acquisition of MIM Holdings Ltd, the court rejected an objector's argument that the scheme had been proposed for the purpose of avoiding the takeover provisions. The court accepted that a scheme was the preferred transaction structure as this was the only way the bidder could fund the transaction given the fact its financiers required an 'all or nothing' outcome in a set period of time.

## Objections

Any target shareholder may attend the final court hearing to object to the scheme if they believe that the scheme prejudices their interests or does not comply with the applicable legal requirements (including the disclosure or voting threshold requirements).

The court may even hear objections from a rival bidder or other aggrieved party. ASIC may also appear at the final court hearing to object to the scheme or draw issues to the court's attention.

Although the court will carefully listen to any objections, it will consider the interests of all shareholders in deciding whether to approve the scheme, not just the interests of the objectors.

#### CASE STUDY — FINAL COURT HEARING OBJECTIONS

In the scheme involving the acquisition of Kasbah Resources Limited, the independent expert changed its opinion from "fair and reasonable" to "not fair, but reasonable" following the scheme meeting (but before the final court hearing) having identified a fundamental error in its (previously adopted) valuation methodology. The court declined an application from the target to adjourn the final court hearing so that the target could renegotiate with the bidder, concluding that doing so was pointless because, even if an improved deal could be reached, the whole scheme process would need to start again.

## 6.8 The mechanical steps to implement the scheme

The scheme will be binding on the target company and its shareholders once the court order approving the scheme has been lodged with ASIC. This usually occurs shortly after the court has approved the scheme.

## 6 The scheme of arrangement procedure

Once the court order has been lodged, the mechanical steps to actually implement the scheme (such as the payment of the scheme consideration to target shareholders and the acquisition by the bidder of all the shares in the target) are carried out on the 'implementation date' specified in the scheme documents.

The implementation date is usually five business days after the scheme 'record date'. The record date is simply the date on which the identity of target shareholders who are to participate in the scheme is determined, and is usually five business days after the date on which the court order approving the scheme is lodged with ASIC.

## 7 Scheme of arrangement or takeover bid?

An initial question before proceeding with any change of control transaction is whether to conduct the transaction as a scheme of arrangement or a takeover bid. Several factors relevant to this decision are outlined in the table below. For more information on takeover bids, contact Herbert Smith Freehills for a copy of our guide to Takeovers in Australia.

SCHEME	TAKEOVER
<b>Key features</b>	
<ul style="list-style-type: none"> <li>• Must obtain target shareholder and then court approval.</li> <li>• Process is driven by the target.</li> <li>• Can generally only be used in friendly deals.</li> </ul>	<ul style="list-style-type: none"> <li>• Only requires acceptances by shareholders.</li> <li>• Process is driven by the bidder.</li> <li>• Can be used in friendly or hostile deals.</li> </ul>
<b>An all or nothing transaction?</b>	
<ul style="list-style-type: none"> <li>• Yes. If the scheme is approved by target shareholders and the court, the bidder will acquire all of the shares in the target.</li> </ul>	<ul style="list-style-type: none"> <li>• Not necessarily. The bidder can obtain full ownership of the target if it acquires <math>\geq 90\%</math> of the target shares. However, 90% minimum acceptance conditions can be (and usually are) waived, thus creating a risk for the bidder of acquiring less than 90% of the target shares.</li> </ul>
<b>Approval threshold to acquire 100% of the target</b>	
<ul style="list-style-type: none"> <li>• 75% by value of shares voted and 50% by number of shareholders voting for each class of target shareholders present and voting at the scheme meeting(s).</li> <li>• Having a 75% approval threshold (as opposed to a 90% threshold in a takeover) does not necessarily mean a scheme is easier to effect. The class voting system, the ability of the court to discount or disregard votes on the grounds of extraneous interests, and the impact of a low voter turnout can make a scheme easier to block.</li> </ul>	<ul style="list-style-type: none"> <li>• The bidder can compulsorily acquire any outstanding shares in the target if it has acquired <math>\geq 90\%</math> of the target shares and <math>\geq 75\%</math> of the shares that the bidder offered to acquire.</li> </ul>

## 7 Scheme of arrangement or takeover bid?

SCHEME	TAKEOVER
<b>Advantages of the bidder holding a pre-bid stake</b>	
<ul style="list-style-type: none"> <li>• Can deter third parties from launching rival proposals.</li> <li>• However, a pre-bid stake cannot count towards the shareholder approval threshold. This means a pre-bid stake reduces the pool of eligible voters.</li> </ul>	<ul style="list-style-type: none"> <li>• Can deter third parties from launching rival proposals.</li> <li>• A pre-bid stake can count towards the 90% compulsory acquisition threshold.</li> </ul>
<b>Prohibited conditions</b>	
<ul style="list-style-type: none"> <li>• Fewer prohibited conditions.</li> <li>• However, the court usually requires that any conditions in the bidder's control must be satisfied or waived before the final court hearing.</li> </ul>	<ul style="list-style-type: none"> <li>• Maximum acceptance conditions.</li> <li>• Conditions depending on the bidder's opinion or events within the bidder's control.</li> </ul>
<b>Flexibility to vary the terms of the offer</b>	
<ul style="list-style-type: none"> <li>• Any variation to the terms of the scheme after the shareholder meeting(s) have been convened may require court consent and the shareholder meeting(s) to be adjourned to give shareholders additional time to consider the variation.</li> </ul>	<ul style="list-style-type: none"> <li>• The bidder can vary the terms of the takeover to increase the offer price or extend the offer period at virtually any time.</li> </ul>
<b>Timetable</b>	
<ul style="list-style-type: none"> <li>• As the courts are closed from mid-to-late December until the start of February, if there is a preference to complete a transaction during this period, this may be a reason for preferring a takeover.</li> <li>• Usually three to four months to effect.</li> <li>• See the attachment at the end of this booklet for an indicative timetable for a scheme of arrangement.</li> </ul>	<ul style="list-style-type: none"> <li>• Generally speaking, the decision to proceed by way of either scheme or takeover will ordinarily not have a material difference on the overall timetable to completion.</li> <li>• Usually three to four months to reach compulsory acquisition.</li> </ul>

SCHEME	TAKEOVER
<b>Independent expert's report</b>	
<ul style="list-style-type: none"> <li>Effectively mandatory.</li> </ul>	<ul style="list-style-type: none"> <li>Only mandatory if the bidder's voting power in the target is <math>\geq 30\%</math> or if the bidder and target have a common director.</li> </ul>
<b>Court involvement</b>	
<ul style="list-style-type: none"> <li>Court approval of a scheme is required and the court supervises all aspects of the scheme.</li> </ul>	<ul style="list-style-type: none"> <li>The court is very unlikely to get involved during a takeover bid.</li> </ul>
<b>Takeovers Panel involvement</b>	
<ul style="list-style-type: none"> <li>The Takeovers Panel is generally reluctant to get involved in a scheme once the court process has commenced.</li> </ul>	<ul style="list-style-type: none"> <li>The Takeovers Panel is the primary forum for resolving any disputes in relation to takeover bids.</li> </ul>
<b>ASIC involvement</b>	
<ul style="list-style-type: none"> <li>ASIC must generally have at least 14 days to review and comment on the relevant scheme documents.</li> <li>ASIC may also attend the court hearings if it believes there are matters that should be drawn to the court's attention.</li> </ul>	<ul style="list-style-type: none"> <li>Prior review of the bidder's statement and target's statement by ASIC is not required.</li> <li>ASIC's role is more limited in takeovers than in schemes.</li> </ul>
<b>Key pros and cons</b>	
<ul style="list-style-type: none"> <li>100% ownership in a set timeframe.</li> <li>Likely that a higher stake is needed to be certain of blocking a scheme than a takeover.</li> <li>Fewer restrictions on conditions.</li> <li>Cannot be used in hostile deals.</li> <li>Independent expert's report is effectively mandatory.</li> <li>Significant court and ASIC involvement.</li> </ul>	<ul style="list-style-type: none"> <li>Can be used in friendly and hostile deals.</li> <li>More flexibility to vary the terms of the offer.</li> <li>Pressure to waive 90% minimum acceptance condition, which increases the risk of minorities.</li> <li>Can be easier for a spoiler to block.</li> </ul>

## 8 Legislative framework

The acquisition of control of listed or widely held Australian companies is governed by a number of different and overlapping pieces of legislation. This section discusses the legislation most commonly encountered. Other specific industry legislation can be relevant—for example, laws governing banking, media, insurance and trustee companies.

### 8.1 Corporations Act

The Corporations Act is the main legislation governing the acquisition of control of listed or widely held Australian companies.

The Corporations Act imposes significant restrictions on the acquisition of shares in listed Australian companies and unlisted Australian companies with more than 50 shareholders. A contravention of these restrictions is serious. It can constitute a criminal offence and may lead to other penalties and the forced divestment of the shares acquired in contravention of the law.

Specifically, the Corporations Act prohibits (subject to certain exceptions) a person acquiring an interest in shares in a listed or widely held Australian company if that acquisition results in the number of shares controlled by the person or their associates increasing:

- from 20% or less to more than 20%; or
- from a starting point that is above 20% and below 90%.

The two main exceptions to the above prohibition are acquisitions by way of scheme of arrangement and acquisitions by way of takeover bid.

### 8.2 Foreign Acquisitions and Takeovers Act

The Commonwealth *Foreign Acquisitions and Takeovers Act 1975 (FATA)* may be relevant if the bidder is a foreign person.

In general terms, the FATA requires that the Australian Treasurer (acting through the Foreign Investment Review Board (**FIRB**)) be notified in advance of a proposed acquisition:

- by a foreign person of 20% or more of the shares of an Australian corporation with total assets or issued securities valued at more than A\$261 million<sup>1</sup> (a higher threshold of A\$1,134 million<sup>2</sup> applies to direct acquisitions by prescribed non-government investors including Chilean, Chinese, Japanese, South Korean, Singaporean, United States and New Zealand companies in non-sensitive sectors); and
- by a group of foreign persons of an 'aggregate substantial interest', being 40% or more of the shares of such an Australian corporation.

Actions which the Australian Treasurer must be notified of are referred to as 'notifiable actions' and include agreements to make proposed acquisitions.

1 This figure of A\$261 million and all other references in this section to A\$261 million applies from 1 January 2018 to 31 December 2018 and is subject to annual indexation.

2 This figure of A\$1,134 million and all other references in this section to A\$1,134 million applies from 1 January 2018 to 31 December 2018 and is subject to annual indexation.

The FATA gives the Treasurer power to prohibit a 'notifiable action' which would be contrary to Australia's national interest.

The Treasurer can also make divestment orders where a transaction has already been implemented without prior approval.

A 'foreign person' includes a foreign government. However, generally most direct investment by foreign governments, their agencies (for example, state-owned enterprises and sovereign wealth funds) and entities in which a foreign government has a substantial interest must be notified to FIRB for review regardless of the value of the investment.

A 'foreign person' may include an Australian entity if an overseas resident owns 20% or more of issued shares or if various overseas residents own 40% or more, even if they are not associated. In applying the second test to listed entities, only holders of 5% or more are counted.

Note that FIRB often wishes to consult with a target company and other relevant regulatory bodies prior to giving approval. This could include communication with the Australian Competition and Consumer Commission (**ACCC**), the Australian Tax Office (**ATO**) and where critical infrastructure assets (such as electricity, water and ports) are involved, the Critical Infrastructure Centre. This consultation process must be managed to avoid premature disclosure of the proposed transaction.

The FATA also contains important provisions, which impose different thresholds and obligations, in respect of acquisitions of:

- Australian land and companies whose Australian land assets comprise more than 50% of the value of their total assets;
- agribusinesses and companies whose agricultural land assets comprise more than 50% of the value of their total assets;
- businesses in sensitive sectors, which include media, telecommunications, transport, defence and military related industries and the extraction of uranium and plutonium or the operation of nuclear facilities; and
- portfolio investments in the media sector of 5% or more.

### 8.3 Competition implications

The competition implications of Australian mergers and acquisitions are dealt with in the *Commonwealth Competition and Consumer Act 2010* (the **CCA**), which is administered by the ACCC.

The CCA prohibits anti-competitive mergers and acquisitions.<sup>3</sup> The relevant test is whether the transaction would have the effect, or be likely to have the effect, of substantially lessening competition in a market in Australia.

There can be no clear definition of what is a 'substantial' effect without a close consideration of the facts in a particular situation. Generally, the ACCC takes the view

3 However, see the ACCC merger authorisation process below.

## 8 Legislative framework

that a lessening of competition is substantial if it confers an increase in market power on the merged firm that is significant and sustainable. For example, a merger may substantially lessen competition if it results in the merged firm being able to significantly and sustainably increase prices. Factors which are relevant to this assessment include post-merger market concentration, barriers to entry and expansion, actual and potential import competition and the availability of substitutes.

There is no compulsory pre-merger or pre-acquisition notification under the CCA. However, the ACCC encourages parties to notify the ACCC well in advance of completing a merger or acquisition where both of the following apply:

- the products of the merger parties are either substitutes or complements; and
- the merged firm will have a post-merger market share of greater than 20% in a relevant market.

This is a low threshold. However, the ACCC considers that, where a merger or acquisition meets the above recommended notification threshold, it could potentially give rise to an Australian competition law issue.

Where there is a potential concern, the ACCC is often asked to provide an informal clearance. If, following a review, the ACCC

determines that the merger or acquisition is not likely to contravene the CCA, it will provide a 'no objection' letter. While such a letter is not binding on the ACCC, past practice shows that it gives a high degree of regulatory comfort. The ACCC considers the vast majority of mergers under the informal clearance process, and clears most without the need for a public review.

In the alternative, a merger party may also make an application to the ACCC for merger authorisation. In order to grant the authorisation, the ACCC will need to be satisfied that either:

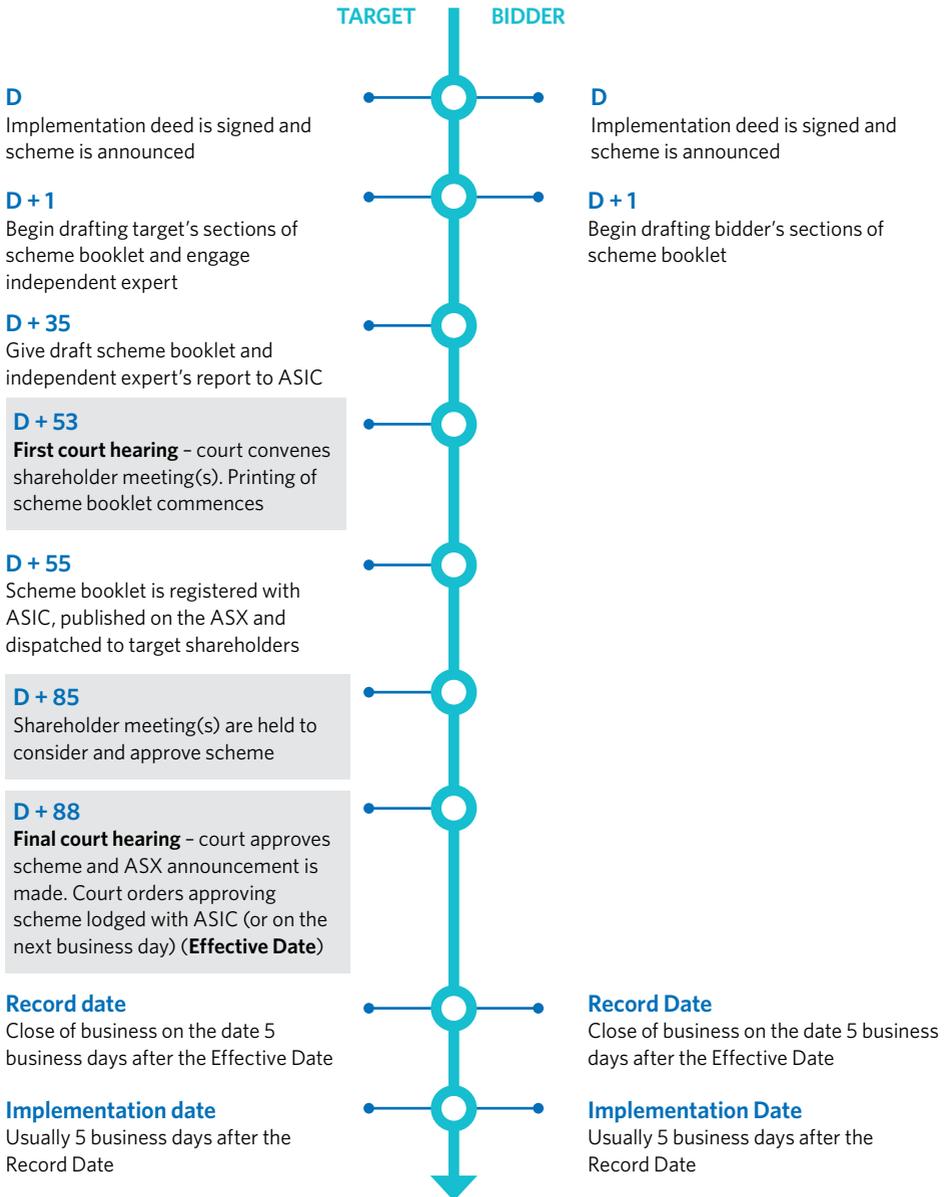
- the proposed acquisition would not be likely to substantially lessen competition; or
- the likely public benefit from the proposed acquisition outweighs the likely public detriment, including any lessening of competition.

Authorisation involves a public process under which interested parties have the ability to make submissions and intervene. On application, the Australian Competition Tribunal may review an ACCC merger authorisation. Authorisation is most likely to be sought where there are substantial public benefits to the merger, as these benefits cannot be taken into account under the informal clearance process.

## 9 Indicative timetable for a scheme of arrangement

<b>ANNOUNCE SCHEME</b>	<ul style="list-style-type: none"> <li>• Sign implementation deed and announce scheme</li> </ul>
<b>DRAFT SCHEME BOOKLET</b>	<ul style="list-style-type: none"> <li>• Bidder and target begin drafting scheme booklet</li> <li>• Target engages independent expert</li> </ul>
<b>PROVIDE DRAFT DOCUMENTS TO ASIC</b>	<ul style="list-style-type: none"> <li>• Target gives to ASIC for review and comment:             <ul style="list-style-type: none"> <li>– draft scheme booklet; and</li> <li>– draft independent expert’s report</li> </ul> </li> </ul>
<b>FIRST COURT HEARING</b>	<ul style="list-style-type: none"> <li>• Court makes orders convening shareholder meeting(s)</li> <li>• Target commences printing of scheme booklet</li> </ul>
<b>REGISTER &amp; PUBLISH SCHEME BOOKLET</b>	<ul style="list-style-type: none"> <li>• Scheme booklet is:             <ul style="list-style-type: none"> <li>– registered with ASIC</li> <li>– published on the Australian Securities Exchange (<b>ASX</b>); and</li> <li>– dispatched to target shareholders</li> </ul> </li> </ul>
<b>SHAREHOLDER MEETING(S)</b>	<ul style="list-style-type: none"> <li>• Target shareholder meeting(s) are held</li> <li>• Target shareholders approve scheme by requisite majorities</li> </ul>
<b>FINAL COURT HEARING</b>	<ul style="list-style-type: none"> <li>• Court approves scheme</li> <li>• Target makes ASX announcement</li> <li>• Target lodges court orders approving scheme with ASIC and scheme becomes effective (the date on which this occurs, being the <b>Effective Date</b>)</li> </ul>
<b>RECORD DATE (CLOSE OF BUSINESS 5 DAYS AFTER EFFECTIVE DATE)</b>	<ul style="list-style-type: none"> <li>• Bidder determines identity of target shareholders who are to participate in the scheme and receive the scheme consideration</li> </ul>
<b>IMPLEMENTATION DATE (USUALLY 5 BUSINESS DAYS AFTER THE RECORD DATE)</b>	<ul style="list-style-type: none"> <li>• Scheme consideration is provided to target shareholders</li> <li>• All shares in target transferred to bidder (in the case of a transfer scheme) or cancelled (in the case of a cancellation scheme)</li> </ul>

## 9 Indicative timetable for a scheme of arrangement



## 10 Contacting us

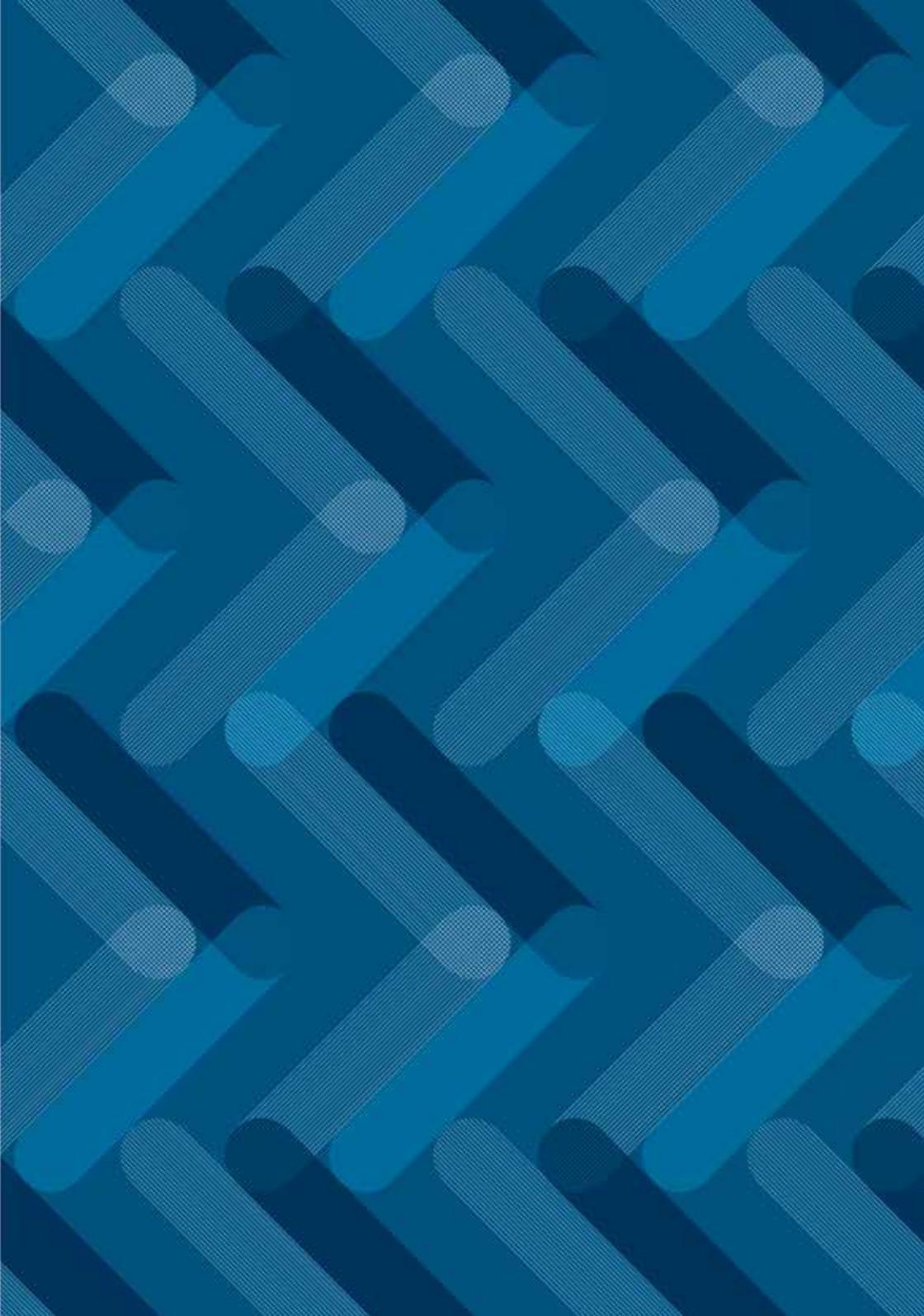
If you have any questions relating to this booklet or any other aspect of schemes of arrangement or corporations law in Australia, please contact one of the partners in the Corporate group at Herbert Smith Freehills in Australia. Details are on our website **[www.herbertsmithfreehills.com](http://www.herbertsmithfreehills.com)**

# Notes

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