DISPENSING WITH THE HEADCOUNT TEST IN SCHEMES OF ARRANGEMENT: THE BOART LONGYEAR SCHEME

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Legal Briefings – By **Simon Haddy, Andrew Rich and Katherine O'Brien**

The recent Federal Court decision in Re Boart Longyear Limited [2019] FCA 62 provides guidance on the circumstances in which a Court may be willing to exercise its discretion to approve a scheme of arrangement despite a failure to meet the headcount test.

IN BRIEF

- The Court found it was open to a Court to dispense with the headcount test where the outcome of a vote has been unfairly influenced by conduct, disclosure, or circumstances affecting how members voted.
- However, in this case, the Court adjourned the second court hearing and recommended Boart Longyear Limited convene a further meeting of members to consider again whether they wished to approve the scheme with the benefit of supplementary disclosure.

BACKGROUND

Boart Longyear Limited (**BLY)**, an ASX listed mining services company with global operations, sought orders to propose a scheme of arrangement to its members in October 2018. By way of background, in 2017 BLY had entered into schemes of arrangement with its secured and unsecured creditors in order to recapitalise the company following the downturn in the mining industry. As part of the recapitalisation, BLY agreed to take all requisite steps to re-domicile its headquarters to the US, UK, or Canada.

Minority shareholder Snowside had unsuccessfully opposed both creditor schemes of arrangement, which had the effect of reducing Snowside's shareholding in BLY from 2.82% to approximately 0.1%. In June 2017, Snowside lodged oppression proceedings relating to BLY's restructuring activities, claiming BLY and its directors "unnecessarily sacrificed the interests of shareholders who were not associated with key creditors."

THE SCHEME

The purpose of the 2018 member scheme of arrangement was to re-domicile BLY to British Columbia, Canada. The scheme was recommended primarily on the basis that it could provide potentially greater access to capital from local institutional investors as well as potential tax and administrative cost benefits.

Snowside opposed the Court making orders convening the scheme meeting and final orders approving the scheme. Snowside claimed implementation of the scheme would unfairly prejudice them by causing them to lose standing or limiting their relief in the oppression proceedings.

Despite Snowside's opposition, the Court made orders for the scheme meeting to be held on 6 December 2018. The second court hearing was listed for 19 December 2018.

THE SNOWSIDE LETTER

In a letter dated 14 November 2018, Anthony Maurici, in his capacity as director of Snowside, wrote to fellow BLY shareholders urging them to vote against the scheme. The letter claimed, amongst other things, that:

a. BLY shares were worth less than one sixteenth of their value prior to the previous restructures;

b. implementation of scheme would likely defeat Snowside's oppressive conduct claim; and

c. minority shareholders may have a potential class action based on oppressive conduct, but this would likely be defeated by implementation of the scheme.

The scheme proxy form accompanied the letter, completed with Mr Maurici named as proxy and the “against” box checked.

The Court authorised BLY to issue a letter to shareholders in response. BLY’s letter:

a. noted Snowside had failed in its attempt to prevent the previous creditor schemes, which were overwhelmingly supported by shareholders;
b. stated it did not agree that the scheme would prejudice Snowside’s standing in the oppression proceedings, noting this was a matter currently before the Courts; and
c. re-iterated its recommendation that members vote in favour.

THE SCHEME MEETING

The BLY scheme meeting resulted in 97.61% of votes cast in favour of the scheme, in excess of the 75% required.

However, the 2.39% of votes cast against the resolution were held by nearly 70% of the shareholders who actually voted (in person or by proxy). Hence the scheme failed the 50% headcount test.

BLY subsequently sought orders dispensing with the headcount test and approving the scheme. The company claimed the integrity of the vote had been undermined by the allegedly misleading claims in the Snowside letter.

BLY led evidence that of the shareholders who appointed the Chairman as their proxy, 365 voted for the scheme and 118 against. Of those who appointed Mr Maurici their proxy, two voted for the scheme and 388 against. Evidence was not called from individual shareholders attesting that the content of the Snowside letter had influenced their vote.

BLY submitted that due to the unfair influence of the Snowside letter, the Court should dispense with the headcount test, arguing this conclusion was supported by:

a. the 97% of votes cast in favour of the scheme reflecting the overwhelming support by those holding a substantial economic interest in the company;
b. the support of those members who are also creditors - given BLY's current debt levels the ongoing support of its creditors is crucial to its survival; and

c. the unanimous support of its directors and independent expert.

PURPOSE OF THE DISCRETION

The power for Courts to dispense with the headcount test was introduced by amending legislation in 2007. The stated rationale for the discretion, as laid out in the Explanatory Memorandum, was to prevent schemes being defeated by share splitting (where small parcels of shares are transferred to parties willing to attend the scheme meeting and vote according to the wishes of the transferor) or other similar situations. That said, the legislative framing of the discretion does not include this (or any other) limitation. Accordingly, it remains open to the Court to exercise its discretion in other scenarios as well. There were suggestions in the *pSivida* scheme in 2008 and in the *Plantic Technologies* scheme in 2010 that the Court may dispense with the headcount test where a large number of shares in the target are held through a custodian on trust for depositary interest holders. However, in neither of these cases did the Court reach a concluded view on this issue.

DECISION

The Court accepted that Parliament intended the headcount test only be dispensed with rarely so as not to undermine a test that protects the interests of minority shareholders. The simple fact of a large number of minority holders casting a ‘no’ vote would not, absent other extenuating factors, give rise to “extraordinary circumstances”. The Court did not, however, accept that the discretion to dispense with the test was limited to cases where the headcount had been unfairly influenced in relation to the calculation of the vote.

Farrell J found it was open to the Court to dispense with the test where the outcome of a vote had been unfairly influenced by conduct, disclosure, or circumstances affecting *how* members voted. Her Honour found that whilst it would not be possible to re-convene the scheme meeting, it would be possible to adjourn the second court hearing and convene a ratification meeting of shareholders. Such a meeting would give members the opportunity to consider again whether they wished to approve the scheme with the benefit of supplementary information.

The vote at this meeting would not be a substitute for the vote taken at the scheme meeting, but a means of assessing the integrity of that vote, and thus informing the Court’s decision as to whether to dispense with the headcount test.

Accordingly, the second court hearing was adjourned to 7 February 2019 for directions. BLY indicated to the Court on 7 February 2019 that it was considering convening another meeting of shareholders to be held on the same day as BLY’s annual general meeting in May 2019 to consider again whether they wished to approve the scheme with the benefit of the supplementary disclosure.

The matter returns to Court on 3 April 2019.

COMMENTARY

The case provides some welcome guidance on the situations where a Court may exercise its discretion to waive the headcount test.

Given that the headcount test remains in the legislation, it is difficult to see a Court adopting an interpretation of the discretion that would effectively render the headcount test largely meaningless.

However, the Boart Longyear scheme highlights the absurdity of the ongoing presence of the headcount test in the context of members schemes of arrangement. The headcount test should be abolished.

Indeed, in her judgement, Farrell J cited Herbert Smith Freehills partners Tony Damian and Andrew Rich, in their text *Schemes, Takeovers and Himalayan Peaks*, as proponents of this view.

In the modern era, it is extraordinary that a large number of small shareholders, who together hold only a tiny fraction of the value of a company, can block the will of those with considerably larger economic interests.

This is inconsistent with the economic precept underpinning the *Corporations Act 2001* (Cth) – that is, one share one vote – and neither the takeover provisions nor the capital reduction provisions contain an equivalent shareholder approval threshold to the headcount test. In 2009, the Corporations and Markets Advisory Committee (CAMAC), sensibly recommended the removal of the headcount test – unfortunately, Parliament has never acted on this recommendation.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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