Information on the Implementation of the Headcount Test for Approving a Scheme of Arrangement or Compromise in Australia

Background

In Australia, in order to tackle the problem of share splitting by parties opposing a scheme, section 411(4) of the Australia Corporations Act 2001 (ACA) was amended in December 2007 to give the court a discretion to approve a members' scheme if it was approved by a 75 percent majority in value even though approval by a majority in number of those members present and voting at the scheme meeting was not obtained. The reasons for the amendment, as stated in the Explanatory Statement to the Exposure Draft of the Corporations Amendment (Insolvency) Bill 2007, were that:

> *"A members' scheme could be defeated by parties opposed to the scheme engaging in 'share splitting', which involves one or more members transferring small parcels of shares to a large number of other persons who are willing to attend the meeting and vote in accordance with the wishes of the transferor. By splitting shares to increase the number of members voting against the scheme, an individual or small group opposed to the scheme may cause the scheme to be defeated. This may occur even though a special majority is achieved in terms of voting rights attaching to share capital, and if the*

share split had not occurred, the majority of members were in favour of the scheme."

2. Prior to the amendment, the court's discretion was limited to either approving or rejecting a scheme that had met both the headcount test and the share value test. The amendment retains the headcount test "unless the Court orders otherwise" and thereby gives the court a discretion to dispense with the headcount test or disregard the outcome of the test. The share value test and the court's general discretion to reject or amend a scheme approved by shareholders remain intact.[1]

3. The ACA does not qualify the discretion given to the court to dispense with the headcount test. However, the Explanatory Memorandum on the amendment indicated that the principal concern is the increase of influence of certain persons under the headcount test by share splitting. The Explanatory Memorandum stated that —

"It is intended that the court would only exercise the discretion to disregard the majority vote under [the headcount test] in circumstances where there is evidence that the result of the vote has been unfairly influenced by activities such as share splitting, however the court's discretion has not been limited to allow for unforeseen extraordinary circumstances."

[1] The amendment to section 411(4)(a)(ii)(A) of the ACA added the words "unless the Court orders otherwise" at the beginning of sub-paragraph (A) so that sub-paragraph (A) reads as follows :-

"(A) unless the Court orders otherwise − passed by a majority in number of the members, or members in that class, present and voting (either in person or by proxy)".

Latest development

4. Our research does not reveal any Australian cases ruling directly on or having elaborate discussion of the court's discretion in dispensing with the headcount test pursuant to the amended section 411(4) of the ACA. However, in making an enquiry with the Australian Corporations and Markets Advisory Committee (CAMAC), we note one possible case for the exercise of the judicial discretion as mentioned in the case *pSivida Limited v New pSividia, Inc* ([2008] FCA 627 at [11] – [12]) where a single shareholder held 53 percent of the total issued share capital on behalf of a very large number of beneficial owners and that shareholder could have been outvoted under the headcount test. The court observed that in such situation, the plaintiff, being the applicant for the court's approval of the scheme, may wish to ask the court to exercise discretion under the amended section 411(4) of the ACA to dispense with the headcount test.

5. In June 2008, a discussion paper on "Members' Schemes of Arrangement" was issued by CAMAC to invite public views on the review of various matters relating to members' schemes of arrangement including whether the headcount test should be amended or repealed. According to the Discussion Paper, there is no known instance where a proponent has succeeded under share value test, but failed to obtain a majority under the headcount test. However, there is anecdotal evidence that in some cases a decision was taken not to embark upon a scheme because of the possibility of an adverse headcount vote. The consultation period for the Discussion Paper ended by the end of September 2008. We understand from CAMAC that the report of the consultation conclusion will be published at around end of January 2010.