17 December 2015

Attention: Gary Hobourn
Office of General Counsel
ASX Limited
20 Bridge Street Sydney NSW 2000
Submitted via email: regulatorypolicy@asx.com.au

Dear Sir/Madam,

Reverse Takeovers - Consultation on Shareholder Approval Requirements for Listed Company Mergers

The Australian Council of Superannuation Investors (ACSI) welcomes the opportunity to respond to the ASX's Consultation Paper on Reverse Takeovers.

ACSI makes this submission on behalf of its members, 29 Australian superannuation funds and 6 major international pension funds, who together invest over $1.5 trillion on behalf of beneficiaries including 8 million working and retired Australians. A significant proportion of our members' assets are invested in the Australian equity market, therefore the governance standards in this market including the ASX Listing Rules are of critical importance.

We would like to strongly commend the work of the ASX in preparing this Consultation in response to investor concerns over the use of reverse mergers in ASX listed companies. A number of recent deals have demonstrated the ability to exploit the gap in the current Listing Rules which allows companies to avoid seeking shareholder approval for company-transforming acquisitions.

Addressing the current gap in the Listing Rules will bring the ASX in to line with peer markets across the globe which have adopted more appropriate thresholds for shareholder approval. However, it is our strong concern that the proposed 100% threshold will fail to bridge the gap in the regulatory framework. There is a real risk that the proposed rule is viewed as an anomaly by global investors as it is three to five times weaker than those set by comparable international exchanges.

ACSI recommends the adoption of a threshold which would provide shareholders a vote on transactions involving the issuance of 25%, or more, of a company's existing equity. Such a threshold would bring the ASX's Listing Rules in line with leading international markets including the LSE, TSX and HKEx.

A detailed response to the specific questions for consultation is included below. I trust that our comments are of assistance to the Consultation and please contact me should you require any further information on ACSI's position.

Yours sincerely,

Louise Davidson
Chief Executive Officer

Annexure – Response to Questions for Consultation

1.(a) Do you think there is a gap in the Australian regulatory framework that warrants a change from the status quo?

(b) Do you consider that there are characteristics of the Australian market which justify a different approach to other jurisdictions (taking into account factors such as other sources of financing)?

1.(a) Yes.

ACSI believes that there is a significant gap in the Australian regulatory framework, which has been highlighted by a number of recent “reverse takeover” schemes between ASX-listed entities.

ACSI is concerned that the current gap in the Australian regulatory framework allows boards to avoid seeking shareholder approval for company-transforming acquisitions. It is significant that this gap does not exist in other developed markets across the world including the major exchanges identified in the consultation paper (Toronto, London, Hong Kong, Singapore, Johannesburg and the New York Stock Exchanges).

While reverse takeovers have been relatively rare in the past, we have witnessed a significant increase in their use in schemes of arrangement in the past two years including:

(a) **Roc Oil’s ‘bid’ for Horizon Oil in July 2014:** under which Horizon Oil shareholders would have represented 58% of ownership in the merged entity had the transaction proceeded;

(b) **Federation Centres’ bid for Novion Property Group in May 2015:** this $11bn deal saw Novion security holders emerge with 64% of the enlarged Federation Centres;

(c) **Independence Group’s bid for Sirius Resources in September 2015:** where Sirius Resources shareholders emerged with 53.2% of the combined entity (as well as receiving cash and demerger scrip consideration);

(d) **Vocus Communications bid for M2 Telecommunications (predicted for 2016):** under the current proposal Vocus shareholders will emerge with around 44% of the combined company even though they will contribute 49% of the market value of equity and receive (based on pre-announcement market cap).

(e) **Vocus Communications bid for Amcom Telecommunications in July 2015:** under which Vocus shareholders became shareholders of close to 46% of the combined company.

(f) **Programmed Maintenance Services bid for Skilled Group in September 2015:** which resulted in Skilled Group shareholders voting on a deal that provided them with a collective holding of 52.4% of the combined entity as well as cash consideration.

In each case noted above the shareholders of the “Bidder” entity were not (or will not be) presented with an opportunity to vote on the transaction.

It is also worth noting that the Sirius scheme and the Skilled Group scheme were promoted as offering substantial premiums to shareholders who would be voting on the transactions. In other words, the transactions were approved by those with most to gain.

All of these deals occurred in S&P/ASX300 companies and in each case the entity that would hold the majority of securities post-merger was considered the 'target' and was therefore provided a vote on the transaction. These six instances in the past two years within the S&P/ASX300 would tend to indicate that reverse takeovers are not "relatively uncommon".

The shareholders in each of the bidder companies above were therefore disenfranchised by the current operation of ASX Listing Rule 7.2. ACSI believes that the absence of a shareholder vote in these transactions is a clear anomaly in the ASX Listing Rules. In ACSI's view, this anomaly exists both in comparative terms relative to peer jurisdictions overseas, and in absolute terms, recognising that such transactions entail a significant change to the fundamentals of the company in question.

In our submission, until these rules are addressed, Australia's equity market will remain out of step with international corporate governance best practice - in particular the principle expressed in Principle II B of the recently-updated G20/OECD Principles of Corporate Governance, that "*Shareholders should be sufficiently informed about, and have the right to approve or participate in, decision concerning fundamental corporate changes such as … the authorisation of additional shares ... (and) extraordinary transactions, including the transfer of all or substantially all assets, that in effect result in the sale of the company*."

ACSI recognises the work of the ASX to address this issue in producing this consultation paper and consultation proposed to address the issue.

1.(b) No.

We do not see any compelling reason why the Australian approach should be different from that applied in other comparable jurisdictions.

2.(a) Do you agree with the implementation of a shareholder approval requirement for issues of securities in excess of 100% of existing capital as consideration for a merger?

(b) If not, why not?

(c) If you consider an alternative threshold would be more appropriate, what would that threshold be?

(d) Are there any alternative indicia you consider should be taken into account?

2.(a) No.

2.(b) Whilst we agree in principle with the setting of a percentage in excess of existing capital as the threshold test for a shareholder approval requirement, ACSI considers the 100% figure to be unduly high, and (as noted above) significantly out of step with other comparable jurisdictions and with reasonable shareholder rights. In effect, adopting a 100% threshold would ensure that the ASX continues to be an outlier compared to global peers. The threshold would be three to five times higher than those set by comparable international exchanges.

As noted below, the 100% threshold may be open to gaming as companies could seek to exploit the proposed rule by simply adjusting the cash/equity mix in the transaction.

It is worth noting that the current operation of the Listing Rules, as well as the proposal included in the Consultation Draft are arguably inadequate for dealing with transactions that deal with a 'merger of equals.'

As a starting point, one would assume a merger of equals would provide equal voting rights to shareholders on both sides of a transaction. While this is standard practice in other markets for both sides of a transaction to vote on a proposal, it clearly does not exist for ASX listed companies.

A 25% dilution threshold would be a more effective mechanism to allow both sides of a 'merger of equals' transaction to vote on a proposal. The introduction of a 100% threshold would only enfranchise shareholders in *some* cases depending on the structure of the deal. For example, the shareholders in a bidder company contributing just over half the equity in a 'merger of equals' (such as a 51%/49% merger ratio between bidder and target respectively) would not be entitled to a vote.

2.(c) ACSI submits that a more appropriate threshold would be 25% or less of existing capital, in line with relevant overseas markets.

2.(d) The percentage of existing capital test appears prima facie to be an appropriate metric, although ACSI would be open to a discussion on whether alternative indicia such as percentage of bidder company assets would technically be a better basis for the test. This test is applied in Hong Kong and the London Stock Exchanges. The detailed construction of the test could we believe be considered in the drafting of an appropriate listing rule amendment.

In either case, our underlying concern is that whichever metric is adopted, it should be a clear, objective and unambiguous 'bright line' test.

3. If a shareholder approval requirement is implemented, do you think it should also be applied to other issues of securities in excess of 100% that are used to fund cash consideration for a takeover or scheme of arrangement? For example, rights issues under listing rule 7.2 exception 1?

Our prima facie response is no, as a pro-rata issue of securities would not involve a similar dilution of existing securityholders.

For instance, the example rights issue would double securities on issue but it would also allow each existing security holder to participate in the issue. This type of transaction would not see control of the entity pass to the owners of the takeover target.

This example raises an important issue regarding the options discussed in question 2. A test based on the bidder company's assets (equivalent to the LSE's premium listing standards) would provide shareholders a vote on this type of transaction.

4.	*Do you agree that, if a shareholder approval requirement is implemented, it should be a "bright line" test rather than a discretionary test?*
	Yes. ACSI submits that the adoption of a discretionary test administered by the ASX, or by referral of specific cases to the Takeovers Panel, would create too much uncertainty around the progress or outcome of particular transactions, and likely involve the body charged with exercising the discretion in protracted and extensive boundary-testing and litigation by market participants.
5.(a) *(b)*	*Do you think the proposal would have a material impact on the ability of ASX listed entities to compete effectively in the market for corporate control?* *Do you think any particular sectors of the Australian market would be more significantly affected than others?*
5.(a)	No. In ACSI's view the concern over listed companies being disadvantaged relative to private companies by a bidder-shareholder approval requirement is over-stated, and has not impeded successful listed company M&A activity in other markets where such a requirement already exists. In any case, companies that choose to raise equity capital on public share markets should generally understand that their access to this ready form of fund raising and liquidity brings with it a reasonable level of accountability to the underlying providers of the capital in question. In this regard, ACSI notes that recent bids for ASX listed companies **Recall Holdings** and **David Jones Limited** saw the bidder companies seek the approval of their own shareholders in the US (Iron Mountain) and South Africa (Woolworths SA) respectively. ACSI notes that the application of rules equivalent to other international markets would only impede deals that were rejected by a company's shareholders.
5.(b)	Not materially. The Consultation Paper suggests a potential relative disadvantage to small to mid-cap resource companies that are more likely to make significant acquisitions relative to their size, and to have more limited access to cash and debt financing options. These commercial realities may have some effect at the margin, but are essentially intrinsic to the types of companies and transactions involved and do not we believe justify either a continuation of the current framework or any special treatment for smaller listed companies relative to larger ones. In our experience, smaller companies regularly hold meetings to seek approval for far less material items including share based payments for executives or minor share placements.

6.	*Do you think that the proposal would lead to transactions being structured to avoid security-holder approval? If so, how might this be done and what would be the consequences of such restructuring?*
	The framing of the proposed measure as a percentage increase in bidder company capital may allow some gaming of the system by companies and their advisers to avoid shareholder approval. This risk is exacerbated by the overly generous dilution limit of 100%. In practice, companies could simply adjust the cash/equity ratio of a scheme of arrangement to avoid the threshold. For instance offering 99% increase through scrip considerations and a cash amount equivalent to another 1%. For this reason, as noted in our response to Question 2(d) above, ACSI would prefer a threshold of 20 - 25% to reduce this risk. ACSI would also be open to the adoption of an alternative metric such as a percentage increase of bidder company assets rather than an increase in share capital as the foundation of the new framework.
7.	*What do you consider may be the direct and indirect costs of the consultation proposal?* *Do those costs outweigh the potential benefits?* *If so, please provide the basis for that view?* *Are there any characteristics of Australian shareholder approval requirements that may make it more difficult to obtain shareholder approval than other jurisdictions?*
	ACSI is not in a position to quantify the direct costs to companies in convening shareholder meetings, but we expect these would generally constitute a relatively small component of the overall transaction and advisory costs. ACSI notes that companies regularly convene meetings to seek approval for equity raisings or to seek approval for equity incentives. Anecdotally, the cost of convening shareholder meetings is roughly proportionate to an entity's size given the relative size of share registers and attendance turnout at company meetings etc. The downside risks of these transactions failing to deliver the expected financial outcomes represents the prime cost borne by investors in bidder companies, who are disenfranchised by the current rules. Addressing this anomaly is we believe the primary consideration, outweighing the direct costs incurred by companies in seeking to obtain shareholder approval.
8.	*Would such a requirement make transactions more difficult to complete? If so, how? What are the potential timing and disclosure implications of requiring shareholder approval for reverse takeovers?*
	Not materially. These approvals are regularly built in to the timelines for transactions in a number of other markets. Given that the target shareholders are asked to approve the transactions under a scheme of arrangement there would be no timing implications if the bidder shareholders were also asked to approve the transaction as the two processes can run in parallel.

8.(a)	*If a shareholder approval requirement is implemented, do you consider any changes to the standard voting exclusions or disclosure requirements would be required? For example, should target shareholders who also hold shares in the bidder be permitted to vote, subject to the usual exclusions for interested or related parties? Should an independent expert's report be required?*
	No. ACSI does not see any need for any changes to the existing voting exclusions or disclosure requirements. As large scale portfolio investors, most institutional investors (including ACSI members) are likely to have some holdings both the bidder and the target companies in most mergers between ASX listed entities. The question of whether an independent expert's report is required should remain a judgment call for the directors of the bidder company, not be mandated. In the case of the Roc Oil/Horizon Oil transaction noted above, Roc Oil produced an independent experts report. In our experience, this was cold comfort for shareholders who could not vote on the deal.
9.	*Are there any other consequential amendments to the listing rules which would be required?*
	N/A.
10.(a) *(b)*	*Do you think such a proposal would have an impact on the willingness of issuers to list, or remain listed, on ASX?* *Alternatively, do you consider failure to implement any changes would impact on the willingness of investors to invest in entities listed on ASX?*
10.(a) 10.(b)	No. It is highly likely that any alternative exchange that they wished to join would have far higher governance standards in relation to this issue than those contained in the consultation paper (or generally comparable standards if our recommended dilution threshold is adopted). Failure to implement changes would be unlikely in itself to be a decisive factor in terms of whether or not to participate in the ASX market as a whole. However, ACSI expects that this issue would likely present a governance discount on ASX listed entities - in the eyes of overseas investors in particular - to the extent that Australian practice remains out of step with the international norm and the current rules permit substantial dilution through reverse takeovers without shareholder consent.
11.	*Are there any additional considerations which should be taken into account?*
	N/A.