HERBERT SMITH FREEHILLS

Submission in response to ASX's consultation paper on reverse takeovers

17 December 2015

1 Introduction

This submission is made in response to ASX's consultation paper dated 10 November 2015 on shareholder approval requirements for listed company mergers (**Consultation Paper**).

Please note that the views expressed in this submission do not necessarily represent the views of all Herbert Smith Freehills partners or of our clients.

2 General submission

We note the response to the Consultation Paper submitted by the Corporations Committee of the Business Law Section of the Law Council of Australia (**Corporations Committee Response**). We agree generally with, and support, the submissions set out in the Corporations Committee Response.

We have set out below some additional observations for ASX's consideration.

In summary, we do not support any further (or different) regulation of reverse takeovers. We consider that the existing applicable laws and rules are working well and have done so over an extended period.

3 Additional observations

3.1 International comparisons

We note that international comparisons are often used to justify the argument that tighter regulation in this area is needed and that shareholders need to be protected against dilution from scrip bids. In response to concerns expressed to ASX on the basis of international comparisons, ASX has included a table briefly summarising shareholder approval requirements for scrip issues in other regulatory regimes.

While those comparisons are interesting, we consider that there is always some danger in cherry-picking a single aspect of one regulatory regime, while ignoring the rest of the regulatory landscape under that regime. We consider that a submission for change based on international comparisons would need to include a comprehensive analysis of the relevant regulatory regime and how any bidder shareholder approval requirements fit within that regime.

In this regard, we note that the Corporations Committee Response identifies some specific differences between the Australian regulatory regime and other regimes that have adopted shareholder approval requirements that affect reverse takeovers.

3.2 Case for change has not been made

As acknowledged by ASX in the Consultation Paper, any regulatory change needs to be made for good reason and the costs of that change need to be worthwhile.

We do not consider that the case for regulatory change has been made for the following reasons:

1 Scrip based deals where the bidder is smaller than the target are an unremarkable feature of Australian corporate life. Transactions may need to be structured that way for a number of reasons, including those set out in the Consultation Paper. There have been over 40 such deals in the last 15 years. There are only 2 instances where there has been any real controversy and each of those involved a major shareholder who wanted to block a transaction, which may have been beneficial to other shareholders, for its own particular individual reasons.

2 In circumstances where there are competing policy considerations, regulators should exercise caution in giving individual shareholders an increased ability to block deals. Shareholder activists and proxy advisers by definition may wish to do exactly that. But a balance must be struck and responsible boards must be given sufficient scope to execute deals that benefit the majority of shareholders without costly and unnecessary hurdles being placed in the way.

3 Similarly, the Consultation Paper recognises the need to ensure that listed companies can continue to compete effectively in the market for corporate control. In our view, requiring ASX-listed bidders to seek shareholder approval would place them at a competitive disadvantage against other bidders, for example private equity bidders, who are not required to seek shareholder approval. This disadvantage is particularly acute in a competitive bidding scenario, where the shareholder approval requirement may limit the bidder's flexibility to vary the terms of its offer. A bidder may have to go back to shareholders for further approval if it varies the terms of its offer to increase the number of shares it will issue (or the variation might itself trigger the shareholder approval requirement), involving delay and additional cost. Seeking upfront shareholder approval for a maximum number of shares would also put the bidder at a disadvantage, in that it would require the bidder to show its hand on what it might be willing to pay for the target from the outset.

4 In terms of costs, the additional cost of these reforms, not just in detracting from a competitive market for control as described above, but also just in terms of the time and cost of convening meetings, should be acknowledged.

5 We note that the term 'reverse takeover' is used broadly, including where the issue at hand is merely one of dilution (that is, a bidder simply issuing many shares) as opposed to control (that is, a bidder issuing shares with the result that a particular target shareholder gains a controlling stake in the bidder post-merger). We agree with ASX that the control elements of the debate are already regulated by, and should properly be left to, the Takeovers Panel (and ASIC), and so the issue on the table in the Consultation Paper is simply dilution.

6 As the Roc Oil transaction noted in the Consultation Paper demonstrated, shareholders can call a vote anyway, even without any regulatory reform. So rather than legislate that every reverse takeover, or a class of them, needs bidder shareholder approval, it could just be left to the odd deal where a major shareholder wishes to take issue.