



Law Council
OF AUSTRALIA

Business Law Section

Office of General Counsel,
ASX Limited,
20 Bridge Street,
Sydney, NSW 2000

Attention: Gary Hobourn
Via email: regulatorypolicy@asx.com.au

15 December 2015

Dear Mr Hobourn,

Response to Consultation Paper – Reverse Takeovers

This is a submission by the Corporations Committee of the Business Law Section of the Law Council of Australia (the **Committee**) in response to the Consultation Paper issued by ASX Limited (**ASX**) on 17 December 2015 in relation to shareholder approval requirements for listed company mergers (**CP**).

While the Committee is aware a small number of corporate governance groups have been very vocal in seeking to impose a shareholder approval requirement on share issues in reverse takeovers, the Committee does not support this proposal. In our view:

- The regulatory benefits (in terms of investor protection) are likely to be very limited.
- The costs and inefficiencies that are likely to result from any change are likely to be substantial.
- The proposed change would be likely to reduce the ability of listed companies to compete effectively in the market for corporate control.
- The board of directors (given the legal obligations of directors to act in the best interests of the company as a whole) is the appropriate body to decide whether to pursue a reverse takeover in accordance with applicable laws.
- The control implications of a reverse takeover are appropriately regulated by the Takeovers Panel and ASIC in accordance with the Corporations Act and it is not appropriate for the ASX Listing Rules to intrude into this area.

The Committee is aware that much has been made of the argument the ASX Listing Rules are “out of line with other international exchanges” that require shareholder approval for these transactions. However, in our view, any change to the ASX Listing Rules should only be implemented if it can be clearly demonstrated the regulatory benefits would outweigh the costs and detriments in the context of the Australian market. In this regard,

GPO Box 1989, Canberra
ACT 2601, DX 5719 Canberra
19 Torrens St Braddon ACT 2612

Telephone +61 2 6246 3788
Facsimile +61 2 6248 0639

Law Council of Australia Limited
ABN 85 005 260 622
www.lawcouncil.asn.au

BLS

we consider international comparisons of a single feature of an overall regulatory regime are of limited value:

- As ASX has noted previously, the Australian market is different from many of its global peers in that it encompasses a wide diversity of companies (by size, type, and stage of life-cycle development) and encompasses a relatively small number of very large companies, a larger number of mid-sized companies and a very long tail of small companies. This means “the rules and regulations governing capital raising need to be flexible to address the needs of this broad demographic of companies”.¹ Many smaller resource exploration companies and early-stage technology companies with limited access to capital are likely to be particularly affected by a rule that increases the costs and risks of a scrip acquisition.²
- The rules adopted by other international exchanges have clearly been shaped by other aspects of their very different regulatory regimes and include features that would not be accepted in the Australian market:
 - In the US, while the NYSE and NASDAQ rules both currently require shareholder approval for reverse takeovers, they impose no restriction on public offerings for cash (either in terms of issue size or discount).³ In this regard, it is significant the US regulatory regime does not otherwise regulate the control effects of reverse takeovers. There is no equivalent of the Takeovers Panel or Chapter 6 of the Corporations Act regulating this space.
 - In the UK, the FCA Listing Rules regulate reverse takeovers as part of a much wider regime that requires shareholder approval for larger transaction outside a company’s ordinary business (including large-scale cash acquisitions). This goes well beyond anything that has been proposed in Australia.⁴

In the Committee’s view, a selective focus on one feature of these regimes without regard to the wider context is likely to be misleading and inappropriate.

- It is also worth noting some of the rules adopted internationally have been controversial and are currently under review. In particular, since the CP was released, NASDAQ has solicited comments on a proposal to allow companies to issue a higher percentage of shares without shareholder approval in connection with an acquisition.⁵ In doing so, it observed capital markets and securities laws have evolved significantly in the 25 years since its current rules were adopted (including through the adoption of stronger corporate governance practices). As a

¹ See ASX Information Paper: “Capital Raising in Australia: Experience and Lessons from the Global Financial Crisis” (2010), p. 10.

² It is worth noting that, in some jurisdictions where there is a second board, it is subject to a less restrictive regulatory regime. For example, we understand the AIM market is not subject to the restrictive rules applicable to the LSE.

³ See Section 312 of the NYSE Listed Company Manual and NASDAQ Rule 5635. See also ASX Information Paper: “Capital Raising in Australia: Experience and Lessons from the Global Financial Crisis” (2010), p. 34.

⁴ The requirement for shareholder approval derives from the Class 1 requirements in LR 10.5. The specific provisions of LR 5.6 do not generally apply if the target has the same category of listing as the bidder.

⁵ See - <https://listingcenter.nasdaq.com/assets/Shareholder%20Approval%20Comment%20Solicitation.pdf>

result, it noted its existing rules “may no longer serve their original shareholder protection purpose and ... may no longer make sense”. It also pointed out companies “may face higher costs of capital by structuring transactions in sub-optimal ways in order to satisfy NASDAQ’s shareholder approval rules”. Clearly, ASX should not simply copy rules from overseas markets when those rules may in fact be thought to have outlived their use-by dates in their home jurisdiction.

The Committee believes the CP provides a thorough assessment of the issues that need to be considered in deciding whether any change to the ASX Listing Rules. The key question is what weight should be given to the identified costs and benefits. In our view, the perceived benefits are likely to be very limited and the costs are likely to be very substantial.

In relation to the perceived benefits, the Committee wishes to highlight the following:

- **There is no history of problems that justifies the change** - The fact ASX is only aware of 2 transactions in the last 7 years where concerns have been raised in relation to reverse takeovers and that in neither of these cases did the transaction proceed because of a successful counter-bid does not suggest there is a compelling need for regulatory change.
- **The control effects of reverse takeovers are already regulated by the Takeovers Panel** - In the Committee’s view, the control effects of a reverse takeover - including the possibility shareholders in the bidder may suffer a reduction in percentage ownership of the bidder (without more) (i.e. voting dilution) or that the bidder may become majority owned by target shareholders - are already appropriately regulated by the Takeovers Panel and ASIC pursuant to Ch 6 of the Corporations Act. Accordingly, we submit it would not be appropriate amend the Listing Rules to address concerns in relation to these effects.⁶
- **The economic terms of a takeover should remain the responsibility of the board** - While the potential for economic dilution as a result of the value implications of a reverse takeover is somewhat different from the voting dilution issues referred to above, we believe it is essentially no different from the value implications of any large acquisition by a listed company, including an acquisition for cash consideration. But, despite having the discretionary power to do so, ASX has never required shareholder approval for large-scale transactions simply because of their scale and we do not understand there is any proposal to change this. In these circumstances, we do not consider there is any reason to single out scrip acquisitions for special consideration. It is the responsibility of the board to ensure the terms of the transaction are in shareholders’ best interests.
- **The proposal would allow bidder shareholders to veto reverse takeovers, but would not give them any right to participate in share issues** - In contrast to a share issue for cash, a reverse takeover is not a transaction in which existing

⁶ This is reinforced by the fact the change would run directly counter to item 4 of s611.

shareholders can participate (otherwise than as shareholders in the target). And the effective pricing of the shares issued under a reverse takeover is typically very different from the pricing of a large-scale placement. As a result, the implications for existing shareholders are very different from a share issue for cash. Imposing a shareholder approval requirement cannot be a way of encouraging a company to extend the benefits of the issue to existing shareholders. Rather it would be a way of giving shareholders an opportunity to veto a particular acquisition proposal. But for the reasons outlined below, we consider the arguments for doing this are very weak.

Conversely, as the CP notes, there are many valid reasons for implementing reverse takeovers. Consequently, imposing a shareholder approval requirement under the Listing Rules that may impede such transactions is likely to have a number of negative consequences. For the most part, these are already identified in the CP, but we would like to highlight the following points:

- **There is likely to be a significant negative impact on the market for corporate control** – We believe there is a very real risk some transactions would not proceed or would only proceed on terms less favourable to the bidder if the proposed changes were adopted. The uncertainties associated with a requirement for bidder shareholder approval for a takeover bid would make any hostile transaction subject to the requirement very difficult to implement. And it is likely a target would be much less willing to support a friendly transaction subject to this uncertainty. As a result, a bidder may be required to offer more attractive terms (as well as additional deal protection measures) to overcome these impediments.⁷
- **The indirect costs of a bidder shareholder vote are likely to be significant** – Apart from the direct costs of preparing and holding a shareholder meeting, a bidder would be required to prepare a Notice of Meeting setting out all information material for its shareholders to decide whether or not to approve the proposed transaction. In essence, this would require it to explain why it believed the transaction would be in their best interests at the same time it was seeking to persuade target shareholders to accept its offer. Identifying (and possibly quantifying) these benefits may materially weaken the bidder's negotiating position in relation to its bid and lead to it being required to offer a more attractive price. As ASX notes in Guidance Note 12 (paragraph 3.1, page 13):

“The imposition of a requirement that a commercial transaction otherwise within the authority of the directors must be submitted to security holders for approval will invariably introduce additional transaction costs, as well as delays and uncertainties that add risk to the transaction. In some cases, it could even threaten the transaction's viability or success. These added costs and risks could well be contrary to the interests of the entity and its security holders.”

⁷ The proposed rule also runs counter to the policy underpinning s629 of the Corporations Act. If a bidder were to have a discretion to recommend its shareholders vote against the required resolution this would effectively give it control over the fulfilment of a bid condition.

- **Bidders may seek to structure transactions in sub-optimal ways** – In seeking to avoid some of these costs and impediments, bidders may offer less scrip than might otherwise have been considered optimal:
 - **This may require a higher price** – If target shareholders are denied roll-over relief and/or the opportunity to share in synergies, this may result in the bidder having to pay a higher cash price to compensate.
 - **This may incur additional funding costs** – If a bidder is forced to use a sub-optimal funding structure that may involve additional cost. And if it is required to raise additional equity by other means, it may be forced to do so before the bid (when the outcome is uncertain) or afterwards (leaving it exposed to market risk for the duration of the bid).
- **A shareholder veto may not always be in a company's best interests** - It needs to be remembered that concerns may arise if the new approval requirement were to prevent a company pursuing a potentially value-adding transaction. While a board has a duty to act in the best interests of the company as a whole, large shareholders can vote selfishly in their own personal interests. That may mean a company that wished to pursue a reverse takeover in what the board considered to be the company's best interests could have the proposal vetoed by a strategic shareholder for reasons that did not reflect the interests of all shareholders (such as its own desire to gain control of the company on favourable terms). In this regard, it is worth noting some of the concerns expressed earlier this year when the major shareholders in AusNet Services Limited voted against a resolution to authorise share issues pursuant to its constitution that might have allowed the company to pursue a particular acquisition opportunity – effectively preventing it from proceeding.

On balance, we believe these costs and detriments far outweigh any benefits likely to be achieved.

We have attached an annexure that provides answers to the specific questions for consultation in the CP. As you will see, we do not believe there is a material gap in the Australian regulatory framework in relation to reverse takeovers and we oppose the implementation of a shareholder approval requirement for them irrespective of the threshold.

The Committee would be pleased to discuss this submission if that is helpful. In the first instance, please contact the Committee Chair, Bruce Cowley, on 07-3119 6213, if you would like to do so.

Yours sincerely,



Teresa Dyson, Chairman
Business Law Section

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

For the reasons outlined in our covering letter, we do not believe there is a material gap in the Australian regulatory framework. And we do consider there are characteristics of the Australian market that justify a different approach to other jurisdictions

2. 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? If not, why not? If you consider an alternative threshold would be more appropriate, what would that threshold be? Are there any alternative indicia you consider should be taken into account?

No. We oppose the implementation of a shareholder approval requirement irrespective of the threshold.

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?

No. The other exemptions under Listing Rule 7.2 appropriately address the dilution that is the principal rationale for the proposed approval requirement.

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. The uncertainties associated with a discretionary test would simply increase the costs and detriments associated with the proposal.

5. 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?

Yes. We do not believe this impact would be confined to particular sectors of the market.

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?

Refer to the comments in our covering letter.

7. What do you consider may be the direct and indirect costs of the consultation proposal? Do you 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?

Refer to our covering letter.

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?

Refer to our covering letter.

9. 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?

We do not consider additional voting exclusions would be appropriate. The approach Courts have taken in schemes of arrangement where shareholders may hold shares in both bidder and target is more appropriate (and highlights the problems with an exclusion of this sort). We also do not consider there to be a need for an independent expert's report given there is no reason for believing the board is not able to exercise independent judgement.

10. Are there any other consequential amendments to the listing rules which would be required?

No.

11. 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?

No and no.

12. Are there any additional considerations which should be taken into account?

No.