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By Email

Dear Director

Consultation paper "Corporate control transactions in Australia" Submission of Tony Damian and Andrew Rich

These are our submissions, made in our personal capacity, in response to the April 2022 Treasury consultation paper regarding possible reforms to the takeover bid and scheme of arrangement regimes, titled "Corporate control transactions in Australia: Consultation on options to improve schemes of arrangement, takeover bids, and the role of the Takeovers Panel" (the **Consultation Paper**).

1 Our experience in schemes and takeovers

1.1 Our recent deal experience

By way of background, we are partners at Herbert Smith Freehills and specialise in schemes of arrangement and takeover bids.

We have half a century of deal experience between us, and we have acted on some of the largest and most complicated scheme of arrangement and takeover transactions in the market in recent times, including in the last two years:

- Advising the Sydney Aviation Alliance on its $32 billion (EV) acquisition of Sydney Airport. This is the largest takeover or scheme in Australian corporate history.
- Advising Santos in its $22 billion merger with Oil Search, effected by way of scheme of arrangement.
- Advising Ramsay Health Care Ltd on its response to the current $20 billion indicative offer from a KKR-led consortium.
- Advising Coca-Cola Amatil Limited on its acquisition by Coca-Cola European Partners by way of scheme valuing Amatil at $11.1 billion (EV).
- Advising Boral Limited in its response to the $8.3 billion unsolicited takeover bid by SGH.
- Advising Link Group in its proposed $3.5 billion (EV) acquisition by Dye & Durham by way of scheme.
- Advising BINGO Industries Limited on its $2.3 billion acquisition by MIRA by way of scheme.
- Advising UAC Energy on its unsolicited $800 million takeover bid for Infigen Group.

We have also acted on a number of smaller schemes of arrangement and takeovers bids, including in more recent times:

- Advising Webcentral on its proposed $12 million acquisition by Web.com by way of scheme of arrangement and the later competing $18 million takeover bid by 5G Networks, including on the Takeover Panel proceedings brought by Keybridge Capital.
- Advising Capgemini on its $95 million acquisition of RXP Services by way of scheme.
- Advising Access Intelligence on its $30 million acquisition of iSentia by way of scheme.
- Advising Todd Corporation on its $71 million takeover bid for Flinders Mines.
- Advising Kokusai Pulp & Paper Co on its $150 million acquisition of Spicers by way of scheme of arrangement.
- Advising Somers in relation to the Takeovers Panel proceedings involving Thorn Group (which then had a market cap of around $50 million).

1.2 Our book on schemes of arrangement

We are the authors of *Schemes, Takeovers and Himalayan Peaks*, a leading textbook on schemes of arrangement. In addition to its detailed analysis of schemes of arrangement in Australia, the book also examines the scheme of arrangement procedure in England and a number of other foreign jurisdictions.

The fourth edition, close to 2,000 pages in length, was published in 2021 (the first edition was published in 2004). *Schemes, Takeovers and Himalayan Peaks* has been cited in over 40 Court decisions and has been described by former Chief Justice of New South Wales Tom Bathurst AC QC as the “pre-eminent text” on schemes of arrangement.

2 Why we do not support substantive changes to the current regime for schemes of arrangement

In respect of the questions in the Consultation Paper regarding the role of the Takeovers Panel (**Panel**) in relation to schemes of arrangement, we hold the strong view that:

- the existing regime in Part 5.1 of the *Corporations Act 2001* (Cth) (**Corporations Act**) (the **Current Regime**) should be retained; and
- the possible new and additional procedure in Chapter 6 of the Corporations Act which would allow a bidder to compulsorily acquire all the shares in a target with a 75% vote and without Court supervision or approval, should not be adopted (even if disputes in relation to acquisitions under that procedure could be heard by the Takeovers Panel) (the **Additional Regime**).

The Current Regime (with its Court supervision) works well, and balances the interests of the various stakeholders: an efficient market for control for bidders on the one hand, with appropriate protections for minority shareholders who can have their shares compulsorily acquired following a 75% vote on the other.

We are aware that there is some limited support for the introduction of the Additional Regime. However, we consider such a regime is unnecessary and unwarranted. That regime would tilt the balance of the acquisition process too far in favour of bidders. It also brings with it a number of other disadvantages.

Some of the main reasons for our view are summarised below:

(a) **Important supervisory role of the Court**

Under the Current Regime, the Court plays an important supervisory role. There are numerous examples of the Court:

- requiring corrective disclosure to scheme documents prior to despatch to target shareholders, and requiring additional disclosure due to new or changed circumstances prior to the scheme meeting; and
- closely scrutinising structural aspects of transactions, particularly those involving side deals with certain shareholders.

It is a materially worse outcome for target shareholders if they are forced to take action themselves in the Panel (at a significant cost to themselves), or to rely on ASIC taking action, as the only means of addressing voting, disclosure or structural defects.

Under the Current Regime, bidders and targets have an obligation to draw to the Court's attention all matters that could be considered relevant to the exercise of the Court's discretion in a scheme (see *Re Permanent Trustee Co Ltd* (2002) 43 ACSR 601 at 603 [7]). The absence of this protection under the Additional Regime would adversely affect the interests of minority shareholders – the disclosure requirements in s636 and s638 to disclose all material information (which mirror the disclosure requirements for a scheme booklet) are no substitute for this duty of candour.

Importantly, the context here is that the compulsory acquisition threshold is set at 75%, which is appropriate under the Current Regime given the various safeguards and protection for minority shareholders. This is discussed further in paragraph (b) below.

(b) **Not appropriate that an acquisition under any new regime be subject to a lower approval threshold than a takeover bid**

There is no cogent policy justification for having only a 75% shareholder approval threshold requirement in circumstances where the need for Court approval is dispensed with.

It has long been accepted that the 75% threshold (as opposed to the 90% threshold in takeovers) is appropriate for schemes of arrangement under Part 5.1 of the Corporations Act because of the protections provided by the requirement for Court supervision of the process and the requirement that the Court consider the fairness of any scheme of arrangement.

During the 1980s and 1990s, there were calls for the voting threshold on a scheme of arrangement under Part 5.1 to be increased from 75% to 90% to make schemes 'equivalent to' takeovers, but each time the Government took the view that a 75% voting threshold on a Part 5.1 scheme was appropriate, in large part because the scheme process also involved supervision of the Court and ASIC.

In particular, the Companies and Securities Advisory Committee (**CASAC**) concluded that it would not be necessary to amend the requisite approval majorities in Part 5.1 of the Corporations Act for schemes of arrangement to align with the 90% compulsory acquisition threshold in Chapter 6 of the Corporations Act for takeover bids because of the procedural protections afforded by the Court supervision of any scheme of arrangement. It was because of these protections that CASAC concluded that it saw no

inconsistency between a 90% threshold for compulsory acquisition in takeovers and a 75% threshold for compulsory acquisition in schemes of arrangement.[1]

Simply put, but for the important role of the Court and its broad fairness discretion, a process that allows for 100% of shares to be compulsorily acquired upon only 75% shareholder approval risks eroding the fine balance between deal facilitation on one hand and the protection against expropriation of minority shares on the other.

If a new procedure is to be included in Chapter 6 which allows for compulsory acquisition of a target shareholder's shares, there will be a strong argument from target shareholders that, given the absence of Court supervision of the process, the voting threshold would need to be 90%, to match the 90% threshold for compulsory acquisition under Chapter 6A of the Corporations Act.

This is an issue on which the Government would need to consult those bodies which represent shareholders in listed companies, like the Australian Shareholders Association, before introducing any such new regime.

(c) **Court approval still essential for many schemes**

Many acquisitions would still need to be undertaken by way of a Court approved scheme of arrangement under Part 5.1, as they could not be effected by using this Additional Regime. For example, many schemes involving an offer of shares (rather than cash) as all or part of the scheme consideration (also known as 'scrip' schemes) rely on foreign prospectus exemptions which are only available if the transaction is approved by a Court.

Also, it is expected that responsible entities involved in trust schemes will continue to require judicial advice from a Court. And, any scheme involving a reconstruction or amalgamation would still need to be undertaken under Part 5.1.

So, by definition, a Court-based procedure must remain. For the reasons described above, having an additional procedure that does not require Court approval would be a backwards step for the legislative regime for the control of listed companies.

(d) **The Current Regime is working well**

It has never been properly articulated why the Additional Regime is necessary. The general view of the market is that Part 5.1 schemes work well, and in fact provide a level of shareholder protection, particularly to retail shareholders, that they are not afforded in takeover bids. The main arguments for the Additional Regime appear to be consistency of decision-making, timeliness of decision making and cost. However:

(1) **The Panel will not result in more consistent decisions**

There is no evidence to suggest that having the Panel determine disclosure and voting issues will result in more consistent outcomes than where those issues are decided by the Court. The fact is that there are a handful of judges around Australia who supervise most schemes compared to 51 part-time members of the Takeovers Panel.

As it has been seen in other areas of the Panel's jurisdiction (like association cases), there is not always consistency of thinking or approach on issues.

[1] See Legal Committee of the Companies and Securities Advisory Committee, "Compulsory Acquisitions Report", Report, January 1996, at 67 [5.11] and 78 [10.8]. See also Legal Committee of the Companies and Securities Advisory Committee, "Compulsory Acquisitions Issues Paper", Report, March 2994, at 29-32.

(2) **The Panel's involvement is likely to lead to delays**

There is no evidence to suggest that having the Panel involved will speed up the resolution of disputes. Again, the contrary is likely to be true.

There will be a few days saved by not going through the Court process (noting that the period between coming out of ASIC and the first Court hearing is a day or two only and similarly for the period between the scheme meeting and the second court hearing), but, if there is a dispute, it will take much longer to resolve before the Panel than the Court. Most complaints around disclosure, voting or structure on schemes are dealt with by the Court almost immediately. When hearing the dispute, the Court has the benefit of having reviewed the disclosures and submissions at the relevant Court hearing. Compared with this, the average time to establish a sitting Panel on a matter is around one week, with an average of three weeks to resolve matters.

(3) **Increased risk of greenmailing**

Disputes before the Panel can also be subject to judicial review applications to the Courts. History has shown that these applications can take years to resolve. By way of contrast, once the Court's orders approving a scheme have been lodged with ASIC, that brings finality to the scheme process.

The possibility of delay from Panel applications and the pursuit of judicial review of Panel decisions will open up opportunities for greenmailers. The mere threat of delay through Panel proceedings (for which they are not at risk of an adverse costs order) and, if unsuccessful in the Panel, a judicial review application may be enough for greenmailers to get their own way.

(4) **The Treasury has previously considered the Court's role to be important**

The Treasury will recall that, as part of the CLERP reform process, it considered whether schemes of arrangement (with their 75% approval threshold) should be allowed to operate as a regulatory alternative to takeover bids (with their 90% compulsory acquisition threshold). The Treasury was, at the time, concerned about 'regulatory arbitrage'.

The Treasury was ultimately comfortable with the applicable safeguards in schemes of arrangement and recommended that schemes of arrangement continue to be available to be used to effect change of control transactions. Relevantly to the current debate, after undertaking a consultation process, the Treasury stressed the importance of the role of the Court (and ASIC's predecessor, the ASC) in the scheme process and stated: *"The involvement of the Courts and the ASC thus ensures that there is adequate shareholder protection"*.[2]

(e) **Cost savings overstated**

Claims that there will be significant cost savings from removing the Court from the Current Regime and / or from implementing the Additional Regime, are overstated.

[2] See the Treasury, "Takeovers: Corporate control: a better environment for productive investment", CLERP Program – Proposals for Reform: Paper No. 4, 1997, at 50-53 [5.2].

Under the Additional Regime, the parties will still need to prepare an explanatory statement (with the same attention to accuracy and completeness of disclosure as is currently the case under the Current Regime for a scheme booklet) and engage the services of professional advisers. In other words, the overwhelming proportion of transaction costs (essentially advisory costs, e.g. financial, accounting, tax, public relations and legal advisory costs) would still be incurred and would not change.

The only costs saved by removing the Court would be the legal costs of the two Court hearings themselves. While those incremental costs might be thought to be high in the context of a scheme for a small market cap company, the reality is that, in the case of smaller transactions, the transaction costs (including the cost of the Court process) are generally lower than in the case of larger transactions.

In any event, there are real integrity benefits in having Court oversight of a transaction under which compulsory acquisition can occur with a 75% vote (instead of at 90%, as is the case in a takeover bid) and having the target company: (i) confirm to the Court that the disclosure is adequate and (ii) disclose to the Court any issues that may be relevant to the Court's discretion.

The cost associated with Court supervision is ultimately borne by the bidder that acquires the target company – that cost is not borne by target shareholders and there is no suggestion that the offer consideration to be paid to target shareholders would be higher if this cost was avoided.

In addition, any cost savings would be lost if, as is likely to be the case, there is an increase in tactical applications to the Takeovers Panel. Applications to the Takeovers Panel are not cheap or quick – they can result in significant delays to transactions. Judicial review challenges from decisions of the Takeovers Panel are even more expensive and cause even greater delays.

3 Potential reforms

We have advocated for some time for a number of changes that could be made to improve the current scheme of arrangement regime. These changes include:

Reform	Summary of proposed reforms
1	Reducing the amount of Court paperwork
2	Repealing s411(17) of the Corporations Act
3	Clarifying the scheme of arrangement disclosure requirements, including repealing the checklist of disclosure requirements in Schedule 8 of the Corporations Regulations
4	Introducing a stand-alone liability and defence regime modelled on that applicable to takeover bids
5	Allowing the scheme of arrangement provisions to be used to effect changes of control of managed investment schemes
6	Expanding on the range of securities that may be the subject of a scheme of arrangement by allowing a scheme of arrangement to be entered into between an entity and any class of security holder. This would remove the doubt which currently exists as to whether options and other convertible securities may be the subject of a scheme of arrangement
7	Amending the provisions relating to independent expert reports to make them consistent with those applicable to takeover bids

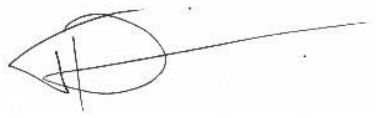
8	Giving ASIC broad modification and exemption powers equivalent to those powers which ASIC has in connection with takeover bids
9	Giving the Court the power to make a binding determination on the composition of classes at the first court hearing
10	Giving the Court specific power to approve a scheme even if the classes have been wrongly constituted or if extraneous interests exist which may otherwise result in the Court overturning the scheme vote
11	Removing the head count test from the member approval requirement
12	Introducing a structured supplementary disclosure regime which is modelled on that applicable to takeover bids
13	Making it clear that any equitable (or other third party) interests in target shares will not be transferred with the shares to the bidder, even if the bidder has actual or constructive notice of the interests
14	Amending the capital reduction provisions in Part 2J.1 of the Corporations Act to again enable schemes of arrangement to take the form of cancellation schemes
15	Removing the requirement to "register" an explanatory statement with ASIC before it is sent to members (and replacing it with a requirement that the explanatory statement be "lodged" with ASIC)

These reform proposals are referred to in Section [17.3] of our book.

These would be refinements that would not involve the removal of the Court, whether through either the Panel assuming the Court's supervisory jurisdiction or by introducing a new regime which does not require any supervision or approval by the Court or the Panel.

We are grateful that the Treasury has provided us with the opportunity to provide submissions on this topic. We would be pleased to discuss any aspect of this submission with the Treasury if that would be helpful. Our contact details are set out below.

Yours sincerely



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