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By email: takeoversregulation@treasury.gov.au

Director
Market Conduct Division
The Treasury
Langton Crescent
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Dear Director

Consultation Paper - Corporate control transactions in Australia

Gilbert + Tobin welcomes the opportunity to make a submission in response to the consultation paper published by The Treasury on 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" dated April 2022 (**Consultation Paper**).

1 Introduction

1.1 The framework for corporate control transactions is an important feature of the Australian corporate landscape which has a significant influence on the attractiveness of Australia's capital markets and perceptions of how it operates will influence the efficient allocation of capital in Australia as well as the investment decisions of both global and local investors. It is therefore critical that the framework achieves an appropriate balance between encouraging efficient control transactions with a robust investor protection regime. In assessing what the appropriate balance should be, it is important to acknowledge that this framework applies to a broad spectrum of companies. Alongside companies that have market capitalisations in the multiple billions, almost 50% of the companies listed on ASX have a market capitalisation of less than $50 million.

1.2 At a high level, it is our view that the existing general principles underlying the framework support an efficient, competitive and informed market for control which strikes an appropriate balance. However, there are circumstances where the current regime is too rigid and inefficient, forcing potential investors or targets to choose a transaction structure not because its features and benefits achieve the desired outcome most effectively and efficiently, but because it imposes the least time, cost and regulatory burden relative to the size or nature of the transaction. In the circumstances where the framework operates in this way, we do not consider that it achieves its objectives which supports the need to expand the framework so that the benefits of the different transaction structures (or the ability to avoid some of the detriments

of these structures) are the same for all companies regulated by Australia's corporate control framework.

2 Making the benefits of the scheme of arrangement process more accessible

2.1 The scheme of arrangement procedure is one which has become the most common form of transaction structure for corporate control transactions in Australia. In 2021, 61% of all deals valued over $50 million, and 86% of all deals valued over $1 billion, occurred by way of scheme of arrangement. The scheme of arrangement procedure is generally preferred by bidders who are able to win the support of the target board from the outset.

2.2 Schemes of arrangement provide certainty of an all or nothing outcome, greater timetable certainty, a lower threshold for success that is not derailed by shareholder apathy and offers greater flexibility in relation to the terms which can be proposed. However, schemes of arrangement do come at a significant cost – there is the need for 2 court hearings, which requires use of counsel, litigation teams and extensive evidence to be prepared about the transaction and the process undertaken as well as greater ASIC involvement as a gatekeeper before you proceed to the court hearings. As a result, it is very often the case that a scheme of arrangement will only be a cost effective procedure for transactions of significant dollar value. Companies with smaller market capitalisations are less likely to choose a scheme of arrangement if the transaction could be completed by way of takeover, solely due to the additional cost and time involved. As a separate matter, it can also be said that the significant costs imposed by the court process (as well as ASIC's gatekeeper role) in schemes are an unnecessary burden in any straight forward scheme of arrangement, whether that be for a large or small company.

2.3 In our view, the scheme of arrangement is a valuable and effective transaction structure, the attractiveness of which is evidenced by the fact that it is the structure used for the great majority of recommended high value transactions. However, it is a transaction structure which is not always considered to be a viable alternative for smaller companies, even though they are subject to the same regulatory regime as Australia's largest companies, due to the additional cost and complexity of the process. In our view, this outcome does not demonstrate a fair application of the regulatory burden across the full spectrum of companies to which the framework applies. In addition, the significant additional costs and time involved in schemes of arrangement seem an inefficient use of resources.

2.4 It should also be noted that the US, which has the largest and most liquid public stock markets throughout the world and the broadest and most sophisticated spectrum of institutional investors in public markets, allows takeovers and mergers with a 50% or 66% shareholder vote without any court supervision. It seems somewhat anachronistic then if Australia wishes to grow its public markets that it has an M&A regime for public companies that imposes unnecessary costs in straight forward transactions.

2.5 We therefore support reform which would introduce a new transaction structure which seeks to adopt some of the benefits of the scheme of arrangement process but in a simplified way that involves less time and cost that the court approved scheme of arrangement process.

2.6 In terms of the detail of this new transaction structure, we are broadly supportive of submissions that we understand will be made by various other practitioners under which it is proposed to adopt a new "**takeover scheme**" structure that would form part of Chapter 6 of the Corporations

Act. While we leave others to comment on the detail of the proposal, the key features of it which we believe are appropriate are:

(a) Requiring target board agreement to use the procedure

(b) Documentation available to shareholders with disclosure equivalent to that which would be provided under a takeover bid as well as the requirement for an independent expert's report in relation to whether the takeover scheme is fair and reasonable

(c) Requirement that the takeover scheme be approved at a meeting of target shareholders by 75% of the votes cast on the resolution (disregarding votes by interested shareholders)

(d) Application of general protections that apply under Chapter 6, such as the equal treatment and minimum bid price rule

(e) Ability for dissenting shareholders to challenge the price payable under the takeover scheme in a similar manner to that used to challenge compulsory acquisition

(f) ASIC to have the same regulatory remit in relation to takeover schemes as it does for takeover bids (importantly, as distinct from its remit in schemes), with the same tools available for regulation and enforcement

(g) Disputes about takeover schemes to be considered by the Takeovers Panel (rather than the courts, unless proceedings are commenced by ASIC), with the Panel to have the same jurisdiction and powers as it does for takeover bids

2.7 We believe that this proposed new structure, which is an addition to and not replacement for any of the current structures under the framework, provides more flexibility to bidders and targets to choose a transaction structure which allows them to conduct a control transaction in the most efficient manner given the specific circumstances. It makes available some of the benefits of the scheme of arrangement process without the complexity and cost of a process which makes the structure an unrealistic alternative for many companies, without losing the key shareholder protection mechanisms that are enshrined in the Eggleston principles. It does not create any greater risk of regulatory inconsistency between Chapter 6 structures and schemes of arrangement than that which already exists.

2.8 There is a risk that the availability of this structure may erode the use of takeover bids, although the fact that it requires agreement of the target and an expert's report, as well as an all or nothing outcome rather than the ability to make incremental acquisitions, means that there will still be sufficient scope for takeover bids to be a valuable and necessary transaction structure.

2.9 The adoption of this new transaction structure will inevitably raise questions about the appropriateness of allowing compulsory acquisition of minority shareholdings while only requiring approval of 75% of shares voted at a meeting under a takeover scheme, rather than 90% of shares on issue under a takeover bid and without the Court's assessment of the fairness of the transaction. However, there are other transaction structures which effect the control of a company available under the Corporations Act which are binding on shareholders who did not vote in favour of them (for example, selective buy backs, selective reductions of capital and approvals under item 7 of section 611 of the Corporations Act) which in some cases (namely,

selective reductions of capital) can lead to compulsory acquisition of their shares without any Court approval process.

2.10 While the majority of the Gilbert + Tobin partners who have contributed to this submission do not think these to be significant concerns, if it was thought necessary to address such concerns, they could be addressed by:

(a) requiring companies who wish to have this transaction structure available to them to adopt specific provisions in their constitution which permit the use of this structure, potentially subject to such approval being refreshed each 3 years in the same way that companies who wish to require that proportional takeovers receive shareholder approval before being permitted must do.

(b) Consideration should also be given to whether this new structure only be available where the consideration offered is cash, given that concerns about binding minority shareholders to a transaction approved by other shareholders without court approval are heightened when that minority is being required to become a shareholder in a different company, with a potentially different investment profile. In any event, given the reliance on a court approval process in some overseas jurisdictions (such as the United States) to permit the issue of securities into the overseas jurisdiction under a foreign scrip transaction, it is likely that many scrip transactions will still prefer the scheme of arrangement structure over the takeover scheme structure.

2.11 While we see as one of the key benefits of the proposed takeover scheme being the simplified and reduced cost of the structure (as compared to the scheme of arrangement), we expect that this structure would be attractive in both high and low value transactions, in the right circumstances. As a result, it will facilitate more effective use of resources and reduce unnecessary regulatory burden, for transactions which do not justify it, allowing greater investment and increasing productivity and would enhance Australia's global reputation for ease of doing business.

2.12 We expect that most market participants take the view that the introduction of this new takeover scheme should not replace the scheme of arrangement given it is a valuable transaction structure which is used in a significant number of transactions with great effect. There are a number of benefits to the scheme of arrangement process which for some transactions could not, or not easily, be replicated by the takeover scheme structure discussed above. For example, the benefits for transactions issuing scrip into the US or certain other foreign jurisdictions (as mentioned in 2.10(b) above), schemes involving situations of insolvency and dealing with creditors as the same time as shareholders and acquisition schemes being undertaken in conjunction with demerger schemes.

3 Other reforms supported by the Business Law Section of the Law Council of Australia

3.1 We have seen the proposed submission by the Business Law Section of the Law Council of Australia and generally supportive of the submissions relating to changes to the current takeover regime in Chapter 6 of the Corporations Act to make it more efficient, reduce unnecessary costs and improve the operation of the regime.

3.2 We are also supportive of the proposal referred to in that submission to work in conjunction with the Federal Court of Australia and the Supreme Court of New South Wales to identify opportunities to reform the court process in relation to schemes of arrangement to make it more efficient, less cumbersome and less costly. That does not however, in our view, replace the

need to consider the takeover scheme structure referred to in paragraph 2 above and we submit that The Treasury process should not be delayed while that is occurring in tandem.

3.3 We are supportive of the introduction of an advance rulings power for the Takeovers Panel as we consider that would facilitate greater certainty for market participants and also develop a greater body of precedent that could guide the market. We do however agree that adding this power to the current remit of the Panel raises a number of matters in respect of its implementation and would likely require additional funding and resources.

We would be pleased to discuss any aspect of this submission with the Treasury. Please contact Karen Evans-Cullen (kevans-cullen@gtlaw.com.au), Neil Pathak (npathak@gtlaw.com.au) or Justin Mannolini (jmannolini@gtlaw.com.au).

Yours sincerely
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