BCA
Business Council of Australia

Corporate control transactions in Australia

Submission to Treasury consultation process

June 2022

Contents

Overview

This is the submission of the Business Council of Australia in response to the Treasury consultation paper *"Corporate control transactions in Australia: Consultation on options to improve schemes of arrangement, takeover bids, and the role of the Takeovers Panel"*, issued in April 2022[1] (**the Consultation paper**).

Members of the BCA are frequently involved in change of control transactions in both Australia and other jurisdictions. The Australian law relating to such transactions, particularly Schemes of Arrangement, is currently inefficient and antiquated. It requires updating to reflect modern commercial practices and keep pace with other jurisdictions with more up-to-date laws.

The over-arching principles for any reform must be that such transactions occur in a transparent and efficient environment that encourages transactions for the benefit of businesses and their shareholders and ensures that they take place in a fair and efficient manner.

Unlike the law relating to Schemes of Arrangement, the law relating to Takeovers is essentially modern and efficient and is a model that should now also be applied to Schemes. The Takeovers Panel has worked well and is considered by business to be a regulatory success. It is clearly a better model than court approval for control transactions, as is still the case for Schemes.

The proposal to extend the Takeover Panel's role to Schemes of Arrangements is strongly welcomed by the BCA. However, it would be undesirable for it to be provided with new court-like functions for which it is not suited. This submission responds to such proposals in the Consultation paper and also puts forward an alternative model for "Takeover Schemes". This model would take the best elements of the law relating to Takeovers and apply them to Schemes, in a manner that would improve efficiency and transparency for all parties.

The BCA's approach to reform

The Consultation paper is focussed on the following proposals:

> *"expanding the role the Takeovers Panel plays in in control transactions, including options for the Takeovers Panel to consider and/or approve members' schemes of arrangement and potentially give advance rulings, with an aim of reducing the time and costs of mergers and acquisitions."* [2]

The BCA supports reforms that simplify the processes for Schemes of Arrangement. These processes are well overdue for regulatory reform. Such reforms should include providing the Takeovers Panel with a role equivalent to the role it plays in relation to Takeovers under Chapter 6 of the Corporations Law. However, the BCA does not support giving new powers to the Takeovers Panel that are not in alignment with its existing role. In particular, the BCA opposes the proposal to give the Takeovers Panel a mandatory role in approving Schemes of Arrangement, a role currently performed by the court.

As an alternative, this submission proposes a new system of "Takeover Schemes" to be enacted in Chapter 6 of the Act, which would operate in a similar manner to the existing Takeovers system. This system would exist as an alternative, more efficient system to the existing regime for Schemes of Arrangement under Chapter 5. The key feature of this proposal is that a Scheme, like a Takeover, would not require approval by a third party, either the court or the Takeovers Panel.

The current regime for Schemes of Arrangement creates unnecessary work, delays and costs for businesses and courts by imposing a judicial approval process for matters that are often routine, commercial transactions. This is an excessive level of regulation. It unnecessarily consumes court resources and adds extra delays and 'friction' to transactions that ought to be able to proceed smoothly.

[1] https://treasury.gov.au/consultation/c2022-263877
[2] Consultation paper, page 4

To the extent possible, there should be consistency between the rules governing Schemes and Takeovers. As a matter of principle, there is no reason why there should be such substantial differences between the two methods of achieving essentially the same outcome. Such differences only exist due to the different historical evolution of each of those methods. In the 21st century corporate environment there can be no justification for retaining such differences.

The goal of reform should be to adjust the rules for Schemes to make them more akin to those that apply to Takeovers. This includes having a similar role for the Takeovers Panel. In addition, other existing Takeover rules should also apply to Schemes, such as minimum disclosure requirements, the minimum bid rule and the rule against collateral benefits.

As the Consultation paper notes, almost every large public company transaction in Australia is carried out through a Scheme of arrangement. This is the most efficient way to undertake such transactions, as the result is determined on the day of the shareholder vote. In contrast, a Takeover can be a drawn-out process with no certainty over either the outcome or the timing.

The Consultation paper also notes that *"broadly, the acquisition of all shares in a company is more expensive when undertaken by a Scheme of arrangement"* and that *"the Scheme process may be too expensive for smaller companies."* It is, to say the least, paradoxical that the more straightforward of the two methods of achieving a change of control is the most complicated from a regulatory point of view.

Schemes of Arrangement

The current law regulating Schemes was established over a century ago. It has not evolved to reflect changes in business practices or technology since that time. It still requires two separate approval processes by a court, which are typically 'rubber stamping' exercises. Notwithstanding that they are largely formalities, the amount of material required to be submitted to the court for each of the two mandatory hearings has progressively increased over time. Further, notwithstanding the long history of court approvals, the considerations to be applied by the court have never been codified in any way and the approach taken differs between different courts and different judges.

The current court-based process is clearly outmoded and not fit-for-purpose in the 21st century. In contrast to the law governing Takeovers, which is informed by the 'Eggleston Principles' that were first developed in 1969 (and have worked well ever since), the law relating to Schemes of Arrangements is still derived from 19th century practice for business insolvencies.

The role of the court was initially mandated in the 19th century when the context for many takeovers was very different. It was focussed on takeovers following insolvencies and based on the concern that small shareholders could be disadvantaged in such arrangements. It is not well-suited to voluntary takeovers where the business is a going concern. There is no reason why a court should be involved at all in such cases. For the same reasons, it should also not be necessary to mandate the role of the Takeovers Panel in approving such transactions, just as the Panel is not required to approve Takeovers.

Schemes of Arrangement are now the preferred means of implementing a control transaction in Australia as they provide greater certainty than Takeovers. Assuming the Scheme is approved by shareholders, they can deliver a certain outcome for all parties at a single meeting, unlike Takeovers, where the processes are less certain. This is particularly important for financing arrangements and other contracts that are reliant on the transaction being approved.

The current law relating to Schemes also has several 'gaps' which reduce its effectiveness, namely:

- Not providing a 'due diligence defence' to directors in the event of any errors in the relevant documents;
- Not enabling ASIC to modify any of the applicable rules, as it can for Takeover bids;
- ASIC does not have the same powers to grant exemptions from certain rules in relation to Schemes as it currently has under section 655A in relation to Takeovers; and

- The rules do not cover listed investment schemes, such as Real Estate Investment Trusts (REITs);

Whilst there is merit in providing a role for the Takeovers Panel in relation to Schemes, this will not be sufficient to adequately update the law relating to Schemes and will still leave these other issues unresolved.

The appropriate role of the Takeovers Panel

The current role of the Takeovers Panel is one of a dispute resolution body, rather than an approval body. Under the current law, a takeover bid enables the parties to prepare their documents and provide them to shareholders without prior approval from a court or ASIC. If a dispute arises, it is determined by the Takeovers Panel, which will adopt a 'commercial' rather than a 'judicial' approach. It would be a notable change in its role to require it to approve transactions, for which it would need to have appropriate skills and resources.

It has been estimated that mandatory court approval for all Schemes has imposed additional costs of around $100 million on businesses over the past ten years[3], all of which is ultimately borne by shareholders. There is a risk that such costs could still be incurred if the role of the court was simply replaced with the Takeovers Panel.

In general, Schemes which involve complex reorganisations or creditors' interests should require approval by an external body, whether a court or the Takeovers Panel. However, straightforward transactions such as the transfer of shares under a "Takeovers Scheme" as outlined below should be able to proceed without external oversight.

Consultation paper proposals

Replacing the court with the Takeovers Panel

We do not believe simply replacing the court with the Takeovers Panel to approve Schemes of Arrangement is warranted. This would change the nature of the Panel, which has always been a review and dispute resolution body. It has never been an approval body for Takeovers, which do not require the approval of any authority.

As a matter of principle, there is no need for Schemes to require approval where Takeovers do not, and where protections for shareholders will continue to exist. In practical terms, the Panel would need to be materially reconstituted to take on a new and distinct role. It would require additional resources to handle the volume of approvals coming before it, many of which will be routine approvals. This may also lead to a change in the member profile of the Panel. Existing members and prospective members may have little interest in simply reviewing non-controversial Schemes. This may materially damage the quality of the Panel, as one of its great strengths is that its members have significant commercial experience and bring their expertise and judgement to bear in considering the matters with which it currently deals.

Simply remove court approval with no Panel role

This proposal is not supported. It does not make sense for Schemes to be outside the purview of the Takeovers Panel but also have no court overview. The Panel should provide recourse for parties who wish to challenge Schemes, just as it does in relation to Takeovers. Typically, the Panel is in a better position to perform this role compared to the Courts.

Establish a new Scheme procedure within Chapter 6

This approach has significant merit and should be seriously considered by the Government. This submission includes a detailed proposal for such a reform – "Takeover Schemes" as outlined below.

[3] "*Making M&A more efficient*", Herbert Smith Freehills, 4 May 2022: https://www.herbertsmithfreehills.com/insight/making-ma-more-efficient

We believe this arrangement should not displace the existing law for Schemes of Arrangement in Chapter 5 but co-exist as an alternative mechanism, to be contained in Chapter 6. The new model could be utilised for more straightforward transactions that simply involve the acquisition of the shares in a company. More complex transactions could still be dealt with under the Chapter 5 rules where the parties consider this appropriate.

As outlined below, this procedure would be aligned with the regime that applies to Takeovers, including similar roles for both the Takeovers Panel and ASIC. It would enable all shares in the target company to be acquired by a bidder by following the proposed statutory procedure for Takeover Schemes.

Such a regime would be a logical evolution of the law relating to control transactions and combine the best elements of the laws relating to Schemes of Arrangement and Takeovers. Like a Scheme of Arrangement, a Takeover Scheme would need to be supported by the Target company, and the Target and the Bidder could enter into an implementation agreement. The shareholder booklet would include statements from both the Target and the Bidder, as required with a Takeover. We also propose that an independent expert's report would be required. Consistent with takeovers, the scheme documentation would not be pre-vetted by ASIC (pre-vetting of takeover documentation was removed in 1990).

The Takeovers Panel would have the power to deal with disputes and ASIC would have standing to bring applications to the Panel, as is the case for Takeovers. As is the case for Schemes, the Target could reserve the right to entertain rival offers. Under this proposal, the approval of 75 per cent of shareholders would be required (not counting those held by the bidder or its associates).

This proposal would achieve regulatory equivalence between Takeovers and Schemes and would greatly reduce 'red tape' and complexity associated with the existing court processes. It should also apply more broadly, including to Managed Investment Schemes and not just to companies.

We do not see any material disadvantages with this concept. We are aware that some lawyers believe that the fact that only a 75% majority is required for a scheme compared to the 90% threshold for compulsory acquisition under a takeover means that court supervision is appropriate for a scheme but not required for a takeover. However, access to the Takeovers Panel is likely to be more effective than court supervision and often the threshold for a scheme is similar to the compulsory acquisition under a takeover anyway because the bidder's holdings cannot be voted under a scheme.

Some commentators have said that most schemes would still need to use the old procedure because they involve scrip consideration and some foreign jurisdictions require an approval by a government body for the issuance of securities without consent. However, only a small minority of control transactions involve scrip consideration and it should be possible to build a deemed approval into the new mechanism.

BCA proposal – "Takeover Scheme" within Chapter 6

A new Part 6.9A should be inserted into the Chapter 6 of the Act to provide for "Takeover Schemes". The process for Takeover Schemes would align with the existing process for Takeovers. As it would be included in Chapter 6, it will be subject to the Eggleston Principles that are included in the Purposes of that Chapter. It would include the following process:

1. **Agreement:** The directors of the Target company must first agree that the procedure may be used (like a Scheme of arrangement, it is only available for a recommended transaction)
2. **Bidder explanatory statement:** The Bidder prepares an explanatory statement for Target shareholders setting out the terms of the proposal. It would align with the equivalent disclosure requirements for a Takeover under section 636.
3. **Target explanatory statement:** The Target issues a statement in response which would align with the equivalent disclosure requirements for a Takeover under section 638. It would also include an expert's report that states whether the proposed Takeover Scheme is fair and reasonable.
4. **Notice of meeting:** Both explanatory statements, having been agreed by each party, are then sent to Target shareholders with a notice of the meeting to approve the Takeover Scheme. These would be sent as a single document.
5. **ASIC and ASX notification:** The document under item 4 is lodged with ASIC and, if the company is listed, the ASX.
6. **Supplementary information:** A supplementary document would be issued by the parties if there is any material change after the notice of meeting is issued.
7. **Voting approval:** The Takeover Scheme would require approval by 75 per cent of votes cast at the meeting (not counting those held by the bidder or its associates).
8. **Equal treatment and minimum bid rule:** All shareholders eligible to vote must receive the same consideration per share, which must equal or exceed the highest price paid or agreed to be paid by the bidder during the 4 month period prior to the date of the notice of meeting.
9. **Effective time:** The Takeover Scheme takes effect once a copy is lodged with ASIC, mandated to occur 7 days after the meeting, which permits any person to apply to the Panel under item 11 below in the event of a dispute. Shareholders must then be paid within 14 days of lodgement.
10. **Dissenting shareholders:** A shareholder who has voted against the Takeover Scheme may apply to a court for an order varying the price payable on their shares if it is determined that it is not 'fair value'. This would be modelled on the process under section 661E for compulsory acquisitions following takeover bids though it would only allow a court to determine fair value where the price offered can clearly be demonstrated to be unfair, not allow the court to stop the compulsory acquisition, which would, at that stage of the process be unworkable for all parties, including the shareholders who supported the proposal.
11. **Disputes and ASIC oversight:** The Takeovers Panel would have the same powers that it has for takeovers under section 657A in relation to 'unacceptable circumstances'. ASIC would also have standing to make an application to the Panel as it does with Takeovers.

This new system would combine the best elements of the existing rules that regulate Schemes and Takeovers. For example:

- The two parties could prepare a combined bidder's statement and target's statements, with an expert's report, and shareholders would vote on the proposal, seeking 75 per cent support of independent shareholders. This would apply only to recommended transactions.

- Non-recommended transactions would still require 90 per cent acceptance for compulsory acquisition.
- Companies would still have the option to use court supervision under Chapter 5 for more complex transactions or arrangements, if they wish. Chapter 5 would continue to be used for transactions such as demergers and corporate reconstructions.

Response to Consultation paper questions

The Consultation paper contains 13 specific questions. This submission does not respond directly to all questions, as some of the matters canvassed by certain questions are addressed elsewhere. This submission considers relevant questions on an 'exceptions' basis.

Takeovers Rules and the Takeovers Panel

1. *What are your views on the current Takeovers Rules? Do takeovers generally achieve outcomes aligned with the Eggleston Principles? Please provide examples where possible.*
    - Takeovers generally achieve outcomes aligned with the Eggleston Principles. The Takeovers Panel works well and has strong support as an institution in the business community.
    - We believe the regime governing Takeovers is currently fit-for-purpose, however, as the Consultation paper notes, most control transactions, and almost every large transaction undertaken in recent times, has been by way of a Scheme of Arrangement.

2. *What changes (if any) could be made to make takeovers more efficient and reduce unnecessary costs?*
    - This submission is concerned with improving the law relating to Schemes of Arrangement. It does not include suggestions about how to make Takeovers more efficient and reduce costs.

Schemes of Arrangement and the Court

3. *What are your views on the Scheme of Arrangement Rules? Do schemes of arrangement generally achieve outcomes aligned with the Eggleston Principles? Please provide examples where possible.*
    - Schemes of Arrangements are not expressly subject to the Eggleston Principles. Most Schemes are non-controversial, so the court's role is often perfunctory. Consequently, the process has become a costly and inefficient process.
    - We believe it is desirable for Schemes of Arrangement to align with the Eggleston Principles. For undisputed transactions, a court is not the appropriate means to achieve this goal.

4. ***What changes (if any) could be made to make members' schemes of arrangement more efficient and** reduce unnecessary costs?*
    - We propose creating a new streamlined arrangement for "Takeover Schemes", to be contained in Chapter 6, as outlined above. This would not require court approval, nor approval by the Takeovers Panel, and would create equivalent roles for the Panel and ASIC in respect of Schemes (as their roles in Takeovers).
    - The existing Scheme of Arrangement regime in Chapter 5 would continue to be available for both members and creditors.

5. *Would there be benefits to establishing regulatory consistency between takeovers and schemes? For example, would there be benefits in aligning the minimum disclosure requirements, the minimum bid rule, and the rule against collateral benefits?*
    - It is highly desirable to achieve regulatory consistency between Takeovers and Schemes and the proposal in this submission for Takeover Schemes will achieve this objective.
    - Whether or not the proposal for a new concept of Takeover Schemes is adopted, it would still be desirable to modernise the rules for Schemes of Arrangement in Chapter 5 to more closely align them

with the more efficient rules applying to Takeovers. Further, there would be merit in implementing measures to streamline the court process, which has become costly and inefficient.

The role of the Takeovers Panel in relation to schemes

6. ***What are your views on expanding the Takeovers Panel's powers to include approval of members'*** *schemes of arrangement? What form (if any) should such a power take? Should a separate regime be* ***established for members' schemes of arrangement for the purposes of a change in corporate control?***

    - There is no reason to expand the Takeovers Panel's role to include approval of Schemes of Arrangement, for the reasons outlined in this submission.

7. *If the Takeovers Panel were to take on some or all of the c****ourt's functions for a scheme of arrangement,*** *what difference to efficiency and costs could this make? For example, if the Chapter 5 scheme of arrangement mechanism was retained and a new procedure was added to Chapter 6 (allowing a Target to convene a scheme meeting, not requiring formal approval from the court, and enabling any party to raise a dispute with the Panel as they can for takeovers), what would be the advantages and disadvantages of such a change?*

    - The numerous advantages of establishing a new Scheme process within Chapter 6 are described above in the proposal for Takeover Schemes.
    - For the reasons outlined above, we do not see any advantage in the Takeovers Panel assuming any of the existing powers of the court.

8. *If the Takeovers Panel were to be given a formal review role for schemes, such as is currently performed by the courts what, if any, changes might be required to:*

- *the scheme of arrangement procedures*
- *the criteria by which schemes of arrangement are considered and approved*
- *the Takeover Rules*
- *the division of responsibilities between ASIC and the Takeovers Panel?*

    - For the reasons outlined above, we do not support this proposal. As such, we make no comment on this question.

Advance rulings

9. *Would an advance rulings power assist in the regulation of control transaction disputes? Would the Takeovers Panel, its executive, ASIC or another party be best placed to exercise such a power?*

    - Providing the Takeovers Panel with the power to make advance rulings may have some benefits for parties in a control transaction, however it would be difficult to make this work well in the Australian context. For example, how could the Panel ensure that all parties who potentially have an interest will be able to be heard?
    - On balance, we do not believe this should be a reform priority.

10. *What features should an advance ruling power in Australia have?*

    - For the reasons outlined in response to Question 9, we make no comment on this question.

11. *How can the Takeovers Panel provide an advance ruling in a way does not result in information asymmetries in the market? Who should the Takeovers Panel consult with or seek input from prior to the making of an advance ruling and in what circumstances should that consultation occur?*

    - For the reasons outlined in response to Question 9, we make no comment on this question.

12. *What impact would the provision of an advance ruling power have on the use of the Takeovers Panel as a dispute resolution forum?*

    - For the reasons outlined in response to Question 9, we make no comment on this question.

General

13. *What other policy options could improve the efficiency and reduce the cost of control transactions, whether by takeovers scheme of arrangement?*

    - Our recommended policy option is outlined above in the proposal for Takeover Schemes.

BUSINESS COUNCIL OF AUSTRALIA

42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 www.bca.com.au

BCA

Business Council of Australia