HERBERT SMITH FREEHILLS

MAKING M&A MORE EFFICIENT

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Legal Briefings – By **Rodd Levy and Robert Nicholson**

Following the release of a consultation paper on proposed changes to schemes of arrangement, takeover bids, and the role of the Takeovers Panel, Rodd Levy and Robert Nicholson discuss their thoughts on potential reform.

Given that Australia is experiencing an M&A boom, you could be forgiven for wondering why the Government is considering possible reforms to our M&A laws.

Last week, the government released a consultation paper seeking input on whether schemes of arrangement could be made more efficient.

Currently, as the consultation paper acknowledges, almost every large public company transaction in Australia is carried out by scheme of arrangement. The key advantage is that you know on the day of the vote whether the transaction is successful. That certainty is vital to many transactions and their financing. It is very different from a takeover, which can drag on for a long time – shareholders are reluctant to tie up their shares until they think enough other shareholders will accept.

The problem, as we see it, is that the law regulating schemes was framed well over 100 years ago. A scheme is a cumbersome and expensive process. It involves two trips to the courts. On the other hand, a takeover bid allows the parties to prepare their documents and send them out to shareholders without prior approval from ASIC or the courts. If there is a dispute, it is decided by the Takeovers Panel, which has the overwhelming support of the market as a commercial decision-maker.

In addition to that basic difference, the current scheme laws do not adequately deal with some basic issues, such as whether directors have the benefit of any due diligence defence if it turns out there is an error in the documents and whether ASIC can modify any of the rules (as it can for takeover bid). It is also clear that the rules cannot be used for a listed managed investment scheme, such as a REIT.

The consultation paper asks whether the Takeovers Panel should take on the courts' jurisdiction for schemes used to effect a takeover. But the Panel is a review body, not an approval body and substituting the Panel for the court just leaves the basic structure (and some basic problems) unchanged.

The consultation paper also raises the tantalising prospect of introducing a new regime, where court or Panel approvals are not required as a matter of course. We believe this idea has real merit.

The requirement for court supervision comes from 19th century creditors' schemes when there was concern about fraud and small creditors being ripped off in insolvencies. The courts were there to protect their interests. This approach was copied over when the law was later amended so that schemes could be used by shareholders (and for a long time its use in that context was also confined to insolvencies), but there is real question as to whether that is necessary.

The USA, the deepest M&A market in the world, does not require court approval for a merger transaction and that market operates just fine. We do not consider that court (or Panel) involvement is necessary in every transaction here. Some lawyers see value in the additional scrutiny but we find it hard to see the valued added and do not see why schemes need that scrutiny and takeovers do not. Further, we estimate that additional costs of at least $100m have been spent on court processes in the last 10 years, all of which is ultimately paid by shareholders.

We consider that a new regime could be introduced, which could combine the best of the rules that regulate schemes and takeovers. For example, the parties would prepare a combined bidder's statement and target's statement, with an expert's report, and shareholders would vote on the proposal, seeking 75% support of independent shareholders. The procedure would only be available to recommended transactions (on the basis that a non-recommended bid should still need 90% acceptance for compulsory acquisition). Any dispute would be dealt with by the Takeovers Panel, using the same principles that apply to takeover bids.

We would expect that, even with this new mechanism, the law would still allow companies to use the court-supervised scheme provisions, if they wished. Companies should have a choice. Complex schemes or transactions involving an issue of scrip to US holders (where a court order may be needed to attract a US exemption), restructures or demutualisations can still proceed that way.

For most transactions, however, we think a new procedure, which did not involve pre-vetting by the courts or the Panel, would be very welcome. It would reduce costs (vital for smaller companies wishing to combine) and equate the scheme disclosures and procedures with the rules for takeovers bids. The Takeovers Panel, which is widely acknowledged to have done a great job in takeover bids, would then deal with any disputes that arise and apply its commercial lens to the issue.

Whatever the outcome of the consultation, the Treasurer should be commended for raising these issues. We have not had a major debate about our basic rules for takeovers laws since the 1990s reforms, which brought us the current Takeovers Panel. It is time these issues were discussed and debated to ensure that Australia's market for corporate control remains efficient and fit for purpose.

Robert and Rodd have produced a detailed paper setting out their proposal to generate discussion.

Download the paper here

This article was originally published in the Australian Financial Review.

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