SQUIRE PATTON BOGGS

Scheming, Away From the Court:

Proposed Changes to Corporate Control Transactions in Australia

April 2022

The Australian government is consulting on a proposal to expand the role the Takeovers Panel plays in control transactions, with an aim of reducing the time and costs of mergers and acquisitions. The proposal includes options for the Takeovers Panel to regulate control transactions by scheme of arrangement ("scheme").

The Current Landscape

Under the Corporations Act (**Act**), corporate control (being a corporation's ability to make decisions), typically may be changed via two transactional processes, being a takeover bid or the implementation of a member's scheme of arrangement.

Takeover bids are governed by Chapter 6 of the Act, whereas schemes are governed by Chapter 5 and ordinarily implemented via court sanctioning processes.

Schemes are usually driven by the target company and require the consent and cooperation of both parties. Court approval is required before an acquisition is complete and, as a result, change of control transactions by scheme may involve a sometimes time-consuming, costly and potentially contentious adversarial process.

Takeover bids, on the other hand, are typically driven by the party seeking to acquire a company. Court approval is not required before the acquisition is complete, but rather the acquisition relies on individual shareholders accepting the bidder's takeover offer.

In Australia, the Takeovers Panel is responsible for resolving disputes concerning takeovers. By contrast, federal and state supreme courts are responsible for approving schemes of arrangements and the Australian Securities and Investment Commission (**ASIC**) is the corporate regulator that oversees all change of control transaction processes. The court and Takeovers Panel require an application to enliven their jurisdiction, whereas ASIC has general oversight and authority to monitor takeover activity and schemes of arrangements, often in consultation with other key market regulators. Further, ASIC has a statutory role in reviewing disclosure documentation for schemes and has an ability to object to a scheme being approved.

As part of the scheme approval process, ASIC is known for intervening and taking adverse positions to scheme proponents in court proceedings.

In this note, we cover the legislative and structural reforms proposed by the Australian federal government that impact the governance of schemes in corporate control transactions.

The Proposed Reforms

In April 2021, the federal government expressed an intention to determine whether it would be appropriate to expand the role and responsibilities of the Takeover Panel to consider or approve schemes of arrangements, with a view to reducing the time and costs of transactions in distressed or non-distressed contexts. The government has now released its consultation paper on the proposed reforms in respect of corporate control transactions, seeking feedback by June 2022[1].

In particular, the government is eager to receive submissions on whether corporate control changes by way of a scheme should continue to be regulated by the courts or whether the jurisdiction of the Takeovers Panel should be expanded such that it ought to exercise authority over such transactions in place of the courts.

The purpose of the proposed reform is said to be:

1. Ensuring all control transactions, whether by takeover bid or scheme, are subjected to the Eggleston Principles, which ensure fair treatment of shareholders in a control transaction. The Eggleston Principles are codified in the Act and must be considered by the Takeovers Panel when determining whether to make a declaration of unacceptable circumstances.[2] On the other hand, there is no statutory equivalent that requires the courts to consider the Eggleston Principles in respect of control transactions by scheme. However, the Eggleston Principles have a role in schemes through ASIC's regard to those principles as part of its role in reviewing schemes and through the court's exercise of its overriding fairness discretion.

1 In August 2021, the Australian government separately released a consultation paper, "Helping Companies Restructure by Improving Schemes of Arrangement", which relates to the use of creditors' schemes of arrangement to restructure severely distressed companies.

2 Corporations Act 2001 (Cth) s 657A.

2. Maximising efficiency and minimising costs and uncertainties in control transactions. Given the increasing complexities and size of control transactions and novel legal issues arising, inevitably the time and cost of the transactions are increasing for parties. The reforms propose to look at methods and mechanisms to decrease the overall costs and time in approving a control transaction by scheme.
3. Ensuring decision-making bodies with responsibility for administering and enforcing control transactions, whether by takeover bid or scheme, have appropriate regulatory powers and that those powers are divided appropriately. The courts, the Takeovers Panel and ASIC all have specific powers and responsibilities in control transactions. The reforms seek to minimise the costs and time and streamline the process in change of control transactions, particularly in relation to judicial scrutiny and approval processes.

The proposed changes aim to achieve those purposes by:

1. Having the review of documentation for control transactions by scheme undertaken by the Takeovers Panel, rather than by ASIC and then the court under the current procedure. By eliminating the role of ASIC in reviewing scheme documentation, the proposal aims to avoid costs and shorten timeframes. The replacement of the role of the court with the Takeovers Panel is seen to be a lower cost option, as legal costs associated with dealing with the Takeovers Panel can be less than for court applications.
2. Replacing the largely implicit disclosure requirements and fairness considerations that currently apply to control transactions by scheme with more prescriptive statutory disclosure requirements (such as a codified statutory regime). Such prescriptive disclosure requirements would mean that disclosure documents for control transactions by scheme could be prepared by the parties more quickly and cheaply. More prescriptive disclosure requirements could also mean that the review of those documents by the Takeovers Panel would be far less involved than what is currently required of ASIC and the court, resulting in shorter timeframes and further reduced costs.
3. Having the final approval of control transactions by scheme given by the Takeovers Panel, rather than by the court under the current procedure. Again, replacing the role of the court with the Takeovers Panel is seen to be a lower cost option, as legal costs associated with dealing with the Takeovers Panel can be less than for court applications.

Limited Efficiency and Unlikely Cost Improvements

The aim of the proposed changes is to improve efficiency and remove unnecessary costs in takeovers. However, in practice, any improvements to efficiency and reduction of costs will be modest under the proposed changes.

There will still be considerable costs associated with the preparation of documentation for control transactions by scheme, as even with prescriptive disclosure requirements, parties would typically rely on lawyers with experience in takeovers to prepare such documents given that those documents would still carry material risk of liability for the parties if they are found to be deficient, misleading or deceptive. Further, more prescriptive disclosure requirements are unlikely to result in materially less disclosure than is currently required for control transactions by scheme, meaning that the time and effort (and, therefore, cost) required for their preparation would be broadly the same as under the current procedure.

There will also still be considerable costs associated with interacting with the Takeovers Panel in the review of documentation for control transactions by scheme and the final approval of such schemes. The reduced timeframes is not expected to be material, in addition the parties will still typically rely on lawyers to interact with the Takeovers Panel.

We expect that to materially improve efficiency and remove unnecessary costs for control transactions by scheme, it would be necessary to:

1. Materially reduce the volume of disclosures required of the parties to effect a control transaction by scheme. It is unrealistic to expect this outcome, as the current level of disclosure required provides equivalency with the disclosure required for a control transaction by takeover bid. There is no clear policy reason why documentation for schemes should be subject to a lower disclosure standard than the equivalent transaction effected by a takeover bid.
2. Materially reduce the role of lawyers in the preparation of documentation for control transactions by scheme. It is unrealistic to expect this outcome unless the documentation becomes a "standard form" box-checking exercise and the liability regime for the parties is modified so that there is far less risk of liability than is currently the case. Again, a materially weakened liability regime for control transactions by scheme is unlikely as it would be materially different to the liability regime that applies to a control transaction by takeover bid, and there is no policy reason to support a difference.

3. Structure the role of the Takeovers Panel in control transactions by scheme so that the process is much shorter and there is no material interaction with the Takeovers Panel that would justify the use of lawyers by the parties (or that would at least mean a reduced role for such lawyers). That outcome would likely require the documentation for control transactions by scheme to become a "standard form" box-checking exercise and the role of the Takeovers Panel to be limited to effectively checking that the form has been completed properly. It would also likely require a reduced ability for shareholders and other stakeholders to be involved in the approval process. Again, it is unrealistic to expect this outcome on a matter as potentially complex as a control transaction by scheme where the interests and rights of shareholders are impacted.

The Courts Are Best Placed to Retain Oversight

Aside from the impact on efficiency and costs, the current regulation of control transactions by scheme has material benefits in terms of the fair level of protection that the current procedure affords all stakeholders and the unique characteristics of the court in terms of the powers, processes and transactional precedents available to it.

As currently stands, stakeholders' interests and rights are afforded a fair level of protection in control transactions by scheme through the role of ASIC, the opportunities afforded to all stakeholders under that process and the oversight of the court.

Although the courts have no statutory obligation to consider the Eggleston Principles in control transactions by scheme, those principles already have a clear application in practice given they are considered by ASIC in determining whether to support the transaction or not.

Also, stakeholders – not limited to shareholders necessarily – are permitted the opportunity to take part in the court processes in control transactions by scheme, giving them an important forum to advocate for the protection of their interests and rights.

Further, during the second hearing, after a substantive scheme meeting has occurred, the court is required to scrutinise the voting and disclosure aspects of the proposed scheme. In doing so, the court:

- Retains the benefit of significant discretions at law and would consider applicable equitable principles and the fairness of the processes taken to that point
- Would apply a higher degree of scrutiny in an open court adversarial context and with the benefit of potentially naturally positioned contradictors, as well as a strong body of legal precedent

The above aspects of control transactions by scheme that afford a fair level of protection of stakeholders' interests would be impossible to replicate in a new regime that eliminates the role of ASIC and replaces the court with the Takeovers Panel. Any new regime would necessarily need to dilute one or more of those aspects, which would be detrimental.

The above is not the total sum of the key benefits of retaining court oversight in control transactions by scheme. In comparison to the courts, the Takeovers Panel is an administrative body. While its jurisdiction is on firm ground, the Takeovers Panel has clear limitations, including not having the same powers available to courts, being constrained by the scope of its key considerations under the Act and not having the benefit of the same judicial processes or transactional precedents available to it.

It is arguable that judicial oversight of control transactions by scheme is preferable to a determination by the Takeovers Panel, particularly where there may be complex or novel legal issues at play, intervention or objection by ASIC or stakeholders not limited to shareholders. Further, unless the composition of the members of the Takeovers Panel changes over time (which in itself may be a detracting factor from changing the status quo), the current members may not necessarily have the requisite experience or expertise, akin to superior court judges, to be able to deal with the matters before them comprehensively. If those concerns prove to be true and a change of jurisdiction does take place, then the ultimate implication may be that the consistency and quality of decisions may not be what is currently expected from, and delivered by, federal and state supreme courts.

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