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Melissa Liu
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Level 5
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Dear Ms Liu

Gadens' submission on ASIC Consultation Paper 228 - Collective action by institutional investors

1. General comments

Gadens is generally supportive of shareholder activism. We believe it shouldn't be ASIC's role to stand in the way of investors acting collectively to better hold boards of publicly listed entities to account.

The rules around takeovers and control transactions are now mature and well developed in the Australian market.

These rules have developed through their infancy with the implementation of the Eggleston Principles articulated in section 602 of the *Corporations Act 2001* (Cth) (**Corporations Act**), Australian Securities and Investments Commission (**ASIC**) Class Orders and Regulatory Guides, Takeovers Panel decisions and Guidance Notes as well as market practice and case law.

Additions to the body of rules surrounding takeovers and control transactions should only be made with the utmost care and in consideration of the impact that those additions will have in tipping the balance between listed entities and their members.

2. Board spills and investor activism

Since the global financial crises there has been a move away from control transactions *per se* as the best means of board accountability. More cost effective means of holding boards to account have been utilised such as member requisitioned meetings to effect "board spills" under sections 249D and 249N (or section 252B and 252L notices in the case of managed investment schemes) (**Requisition Notices**) of the Corporations Act.

As you are aware members holding greater than 5% of the votes in a listed entity are entitled to requisition a meeting of members. Relevantly, persons with a substantial holding of 5% or more of a listed entity are also required to disclose that interest under section 671B if the Corporations Act.

As part of requisitioning a meeting of members, including for the purposes of spilling the board, it is imperative that members be able to communicate freely not only for the purposes of meeting the 5% requisition threshold but also to discuss the business to be transacted at the meeting.

As is commonly the case, a board which is threatened with a members' meeting will do everything in their power to defend their position including making complaints to ASIC and an application to the Australian Takeovers Panel. In this context it is against the incumbent directors' interests for members be allowed to communicate with one another and otherwise gather votes against those directors.

It is a common strategy of security holder activists seeking to rejuvenate and reinvigorate boards to get as many other security holders as possible to sign a Requisition Notice to show the incumbent board the level of security holder support for a change on the board. The ASIC proposals will effectively limit the percentage of members willing to sign a Requisition Notice to less than 20% for fear of breaching the takeovers threshold. Large security holders will be particularly wary of signing a Requisition Notice with other security holders due to the risk.

3. Class Order CO [00/455]

ASIC CO [00/455] (**CO [00/455]**) modifies section 609 of the Corporations Act so that (subject to the satisfaction of certain conditions) institutional investors, who hold a relevant interest or voting power in greater than 5% of a listed entity's securities and who became parties to a voting agreement in relation to a meeting of the entity's members, do not have an aggregated "relevant interest" or "voting power" and do not need to file a substantial holding notice under section 671B of the Corporations Act.

By ASIC's admission in the Consultation Paper 228, as far as it is aware only one group of institutional investors has ever taken advantage of CO [00/455]. The reasons ASIC have suggested for this include that:

(a) institutional investors rarely seek to engage with companies at the meeting itself and the relevant investor engagement is usually done prior to or outside of meetings; and

(b) a condition imposed on CO [00/455], to disclose details of the voting agreement seven days prior to the relevant meeting (**Disclosure Condition**), was unpalatable.

We would add to this that in practice the Disclosure Condition is not dissimilar to the obligation to file a substantial holding notice (and documents supporting the acquisition of the substantial holding) in the ordinary course.

It is in light of the defunct nature of the CO [00/455] that ASIC is exploring not remaking it.

4. Regulatory Guide 128

Aside from a brief discussion around "associations" and "relevant interests" at RG 128.4 of the Regulatory Guide 128 (**Old Regulatory Guide**) the majority of the Old Regulatory Guide is devoted to the operation of CO [00/455].

We would argue that the inclusion of the discussion at RG 128.4 is only necessary as background information to better explain the purpose of CO [00/455] in any event.

Without CO [00/455], the Old Regulatory Guide serves little purpose other than to add to the existing regulatory guidance provided in Regulatory Guide 5 around the concepts of "associations" and "relevant interests"; concepts that are well understood in the market and particularly in the institutional investor space.

Regulatory Guide 5 already discusses both of these concepts in depth and includes, in Part C, an extensive discussion of their practical application.

5. Use of ASIC materials in Australian Takeovers Panel proceedings

In the context of proceedings before the Australian Takeovers Panel, parties will use all necessary means to convince panel members of the non-existence of circumstances that constitute "unacceptable circumstances"; including failure to comply with section 671B and breaches of the 20% rule. This involves submitting extensive references to ASIC class orders, regulatory guides and policy statements.

Should ASIC take the view that a prescribed set of circumstances constitute a potential relevant interest (such as in Table 2 of the new draft Regulatory Guide 128 (**New Regulatory Guide**)), this may constitute a compelling argument that a relevant interest does in fact exist despite any factual evidence to the contrary.

6. New Regulatory Guide 128

In the New Regulatory Guide ASIC includes on page 13 examples of "Conduct more likely to constitute acting as associates or entering into a relevant agreement giving rise to a relevant interest". Under that heading, ASIC suggests that institutional investors who sign Requisition Notices are likely do so "with an understanding about the exercise of voting rights that will amount to the acquisition of a relevant interest".

Although aggregated for the purposes of calculating "voting power", "associations" and "relevant interest" are distinct concepts with profound implications in relation to the takeovers rules. The key element of section 606 of the Corporations Act is the *acquisition* of a "relevant interest" rather than the creation of a 20%+ "association".

In particular, whether a person has "the power to exercise, or control the exercise of, a right to vote attached to the securities" is a factual matter that ought not be simply assumed in the circumstances but rather made out on the facts. Proving this has been the subject of numerous Australian Takeovers Panel proceedings.

In our view the automatic assumption that signing Requisition Notices is likely to be accompanied by voting agreement or understanding is incorrect and runs contrary to the legislative intent of their proscribing sections.

The suggestion also creates regulatory risk for any investor with a substantial holding (or indeed any holding at all) who signs a notice and risks being accused of breaching the takeover provisions.

A party who signs Requisition Notices is under no obligation to vote in favour of any proposed resolutions. The requisition of the meeting or proposal of a resolution is a power granted to the members who hold votes but not an exercise of votes or voting power. Signing a requisition of meeting or resolution should not automatically be treated as arrangement to vote in favour of the resolution(s).

In our view institutional investors or any other shareholder ought to be free to sign Requisition Notices, absent any other arrangements, without fear of breaching the takeover rules. We believe ASIC may be creating uncertainty in this regard.

ASIC seems to have overlooked the fact that there is an express exception to the "relevant interest" rules for proxies (section 609(5)). So, on ASIC's analysis, signing a board spill notice is 'likely' to result in a "relevant interest" but if the investors in excess of the first 5% (by "voting power") gave their proxies to the first 5% of investors who sign the board spill resolution, there would be no "relevant interest" because of the proxy voting exception.

Surely if you can give a proxy to vote on a board spill resolution without breaching the takeovers threshold you should be able to sign a Requisition Notice requesting a meeting to be held to consider such a resolution.

7. Is a new Regulatory Guide necessary at all?

Assuming that the CO [00/455] is not "remade", collective action by institutional investors will be treated in substance no differently from collective action by other investors in listed companies and managed investment schemes.

The operation of the "associate", "relevant interest" and "voting power" concepts are discussed extensively in the case law, ASIC Regulatory Guide 5 and decisions of the Australian Takeovers Panel.

The approach taken to the provisions has been to keep them broad with a clear anti-avoidance intent.

The provision of further examples of what is and isn't likely to constitute an "association" or "relevant interest" by ASIC only creates further uncertainty and unnecessary ammunition to parties in control transaction and board spill disputes.

If CO [00/455] is not remade, we are of the view that Regulatory Guide 128 need not be reissued. Not only will the New Regulatory Guide no longer relate to any class order but it will only serve to unnecessarily add to the extensive body of regulatory guidance provided by ASIC and the Australian Takeovers Panel.

Yours sincerely

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