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To:	Stub Equity; Kim DeMarte
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Subject:	Allens Submission in Response to Consultation Paper 312 - Stub Equity in Control Transactions
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Kim,

Thanks for the opportunity to make submissions in response to Consultation Paper 312. Allens' comments on the paper and the draft instrument are as follows:

1. Offers of securities in proprietary companies

We don't agree with ASIC's proposal to prevent offers of stub equity in proprietary companies. That is because we think that, with adequate disclosure, target shareholders should be able to make a decision to elect to receive stub equity in a proprietary company, even if it means that the governance and disclosure provisions of the Corporations Act which apply to public companies but not proprietary companies (e.g. related party transactions; restrictions on conflicted directors; annual meetings; and periodic financial reporting) would not apply. We note, however, ASIC's comments in the paper about the intent of section 113(3), and ASIC's view that proprietary companies are not an appropriate vehicle for offerings to a large number of investors, irrespective of whether prospectus disclosure or equivalent is given. So we are not sure we can take that much further. In any event, our much greater issue is in relation to the ASIC proposal to prevent offers of stub equity with mandatory custody arrangements designed to have the effect that Chapter 6 does not apply. This is discussed below.

2. Offers of securities incorporating mandatory custody or securityholder arrangements

As noted in the paper, this is a new point being raised by ASIC, post the original ASIC media release. While we can understand ASIC's position on preventing offers of stub equity in a proprietary company, we strongly disagree with ASIC preventing an offer of stub equity in a <u>public</u> company which has a mandatory custodian arrangement designed so that the takeover provisions in Chapter 6 do not apply. We see the takeover provisions as being in a different category to the governance and disclosure regime applying to a public company, in that a target shareholder should be able to give informed consent at the time of accepting an offer that they will receive shares in a company which will not be subject to the provisions of Chapter 6. In other words, even if ASIC's view is that a target shareholder can't understand what they are agreeing to when they give up the corporate governance and disclosure protections for a public company, because they may not know the circumstances which may arise in the future, a target shareholder can readily understand that if Chapter 6 does not apply then a person can acquire more than 20% of the company without a takeover bid. We think that is something that a target shareholder, even a retail shareholder, can give an informed consent to.

The Consultation Paper also does not look at the real reasons why a private equity controller, and the target shareholders who have accepted the stub equity, may not want the takeover provisions to apply to the Holdco down the track. In our experience, it is <u>not</u> because the PE controller want the freedom to sell its majority shareholding in the Holdco to a third party without sharing a control premium with the minority shareholders. Stub equity shareholder agreements invariably include tag rights in favour of the minority shareholders, which means that when the PE controller wishes to sell to a third party, the minority shareholders can have their shares acquired on the same terms anyway. Also, if the PE controller is looking to sell, they will want to sell 100%, and if they are exercising their drag rights, they can only do so on the same terms as they are receiving for their shares from the third party purchaser. So avoiding the need to share a control premium with the minorities is not the reason that a PE controller may not want the takeover provisions to apply. In our experience, the issues are more the following:

* It will add considerable procedural complexity and cost to an exit down the track if the third party purchaser has to, at the same time, make a formal takeover bid for the Holdco, or proceed by way of scheme of arrangement. The exit is already governed by the pre-emptive rights, drags and tags in the shareholders agreement, which are difficult to make operate if the third party purchaser also has to make a formal takeover bid, or proceed by way of scheme of arrangement.
* The other issue here is that because of the pre-emptive rights, drag-along option and tag-along option in the shareholders agreement, all shareholders (i.e. the private equity controller holding the 'A' class and the minorities holding the 'B' class) will have a relevant interest in each other's shares, and consequently will have voting power in 100% of the company. This means that if Chapter 6 does apply to the Holdco, no shareholder (including any minority shareholder) can sell any of its shares to someone who is not an existing shareholder without the third party purchaser making a takeover bid for the entire company. In practice, this would mean that a minority shareholder could never sell their shares, other than to an existing shareholder. This would be an unintended consequence of requiring

Chapter 6 to apply, even when all shareholders have agreed that it will not.

For these reasons, ASIC should not proceed with clause 5 of the draft instrument (or, if it does propose to modify the law by inserting the proposed section 615A, that modification should not apply if the shareholders agreement includes tag-along rights, so that if the PE controller wishes to sell all or a material part of its shareholding, it must ensure that minority shareholders have the right to sell the same proportion of their Holdco shares on terms no less favourable to the minorities than the terms offered by the third party purchaser to the PE controller).

If ASIC does proceed with the proposed amendment to prevent offers of stub equity with a mandatory custody arrangement, there is a real risk that because of the Chapter 6 issues referred to above, bidders cease to offer a stub equity alternative at all. While it may not be attractive to all target shareholders, a stub equity alternative affords target shareholders with the opportunity to invest alongside the private equity investor, and not pay any fees throughout the duration of the investment. This is potentially a valuable opportunity for target shareholders. ASIC should be slow to take action which would mean that retail shareholders would be deprived of the opportunity to invest in this asset class.

Please let us know if you have any questions in relation to the above.

Regards

Guy and Tom

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