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By email

Kim Demarte
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Australian Securities and Investments Commission
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Dear Mr Demarte

Submission on ASIC Consultation Paper 312: Stub equity in control transactions

Thank you for the opportunity to make comments in response to ASIC's Consultation Paper 312: Stub equity in control transactions (**CP312**).

In relation to Proposal B1 and subject to our views on Proposal B2, Gilbert + Tobin has no objection in principle to ASIC requiring offers of stub equity to be made via an Australian public unlisted entity, provided that the disclosure exemptions in sections 708(17) and (18) of the *Corporations Act 2001* (Cth) (**Corporations Act**) are available to the relevant entity regardless of whether or not a custodian arrangement is used.

In relation to Proposal B2, we submit that it is not appropriate to, and there is no public benefit from, legislating against the use of an Australian unlisted public company with a custodian structure in an offer of stub equity.

We do not expect the modifications proposed in Proposal B2 will result in changes that will substantively address ASIC's concerns.

We do not expect private equity investors would be prepared to own an Australian public company that is subject to Chapter 6 of the Corporations Act as it would significantly constrain and limit the ability of the private equity investor from realising its investment. In our view the most likely outcome of Proposal B2 is that private equity investors will revert to the use of foreign entities as offerors with the perverse outcome that there would be significantly less protections for retail shareholders than would be available through an Australian unlisted public company with a custodian arrangement.

The Annexure to this letter contains our specific submissions on the proposals.

Please do not hesitate to contact Rachael Bassil or Olivia Blakiston if you would like to discuss our submission with us.

Yours faithfully
Gilbert + Tobin

Annexure: Feedback on Consultation Paper 312: Stub equity in control transactions

CP312 reference and proposal	ASIC question	Submissions / feedback
Proposal B1*: We propose to make a new legislative instrument modifying Ch 6D so that the disclosure exemptions in s708(17) and (18) do not apply to offers of securities in proprietary companies.*	**Question B1Q1:** *Do you agree with our proposal to prevent offers of stub equity in proprietary companies to retail investors under the exemptions for control transactions? If not, why not?*	Subject to our response to Proposal B2, we have no objection in principle to ASIC requiring offers of stub equity made via an Australian entity to be an unlisted public company and not a proprietary company, provided that the relevant disclosure exemptions in section 708(17) and section 708(18) are available to Australian unlisted public companies regardless of whether or not a custodian / nominee arrangement is used. For the avoidance of doubt in relation to statements made in ASIC's media release 19-127MR (and again subject to our response to Proposal B2), we would have a strong objection to any modification of Chapter 6D that would have the result of disapplying the disclosure exemptions in section 708(17) and section 708(18) to offers of securities in public companies which are in the nature of stub equity. Such a modification would result in the potential acquirer having to issue a prospectus in order to issue stub equity consideration as part of a scheme of arrangement or takeover bid. We consider that there is no justification for requiring potential acquirers (and their directors) to take on increased liability for a document that would be produced largely in reliance on information provided by the target entity, and for such transactions to be subject to conflicting acquisition and prospectus timetables. We note that, in the context of a scheme of arrangement (where most stub equity structures have been utilised), ASIC already has the ability to review, comment on and sign off on the relevant disclosure document as a result of ASIC's statutory review period prescribed by section 411(2) of the Corporations Act. We would see no benefit in the additional process, cost and delay to the transaction timetable.
	Question B1Q2: *Do you have any comments on the form of the proposed legislative instrument in so far as it modifies Ch 6D?*	See response to Question B1Q1.
Proposal B2: *We also propose to modify Ch 6 so that the exceptions in items 1-4 (takeover bids) and 17 (schemes of arrangement) of s611 are not available where securities are offered as consideration on terms (including terms in the constitution of the issuer) that require that scrip to be held by a custodian and/or subject to a securityholder agreement or similar arrangement, where*	**Question B2Q1:** *Do you agree with our proposal to prevent offers of stub equity where the terms of the offer require the scrip to be held by a custodian or subject to an agreement that avoids:* *(a) the application of the takeover bid provisions in Ch 6 or the disclosing entity provisions in Pt 1.2A; or* *(b) the 50 non-employee shareholder limit in s113(1)?*	Pursuant to section 655A(2), in deciding whether to make a declaration in respect of section 611, ASIC must consider the purposes of Chapter 6 as set out in section 602 – being to ensure that, relevantly, the acquisition of control over the voting shares in a listed company, or an unlisted company with more than 50 members, takes place in an efficient, competitive and informed market. It is important to draw a distinction between: • the control transaction governed by Chapter 6 pursuant to which the stub equity is offered and in connection with which ASIC is seeking to modify the operation of section 611 (being a transaction that is governed by Chapter 6, the **Regulated Transaction**); and • a future potential control transaction relating to the entity that makes the offer of stub equity. As acknowledged by ASIC in paragraphs 12 and 34 of CP312, the use of such custodian arrangements are not illegal and can have the consequence that Chapter 6 does not apply to future control transactions.

CP312 reference and proposal	ASIC question	Submissions / feedback
doing so results in the issuer avoiding the application of: *(a) the shareholder limit in s113(1);* *(b) s606; or* *(c) the disclosing entity provisions in Pt 1.2A.*	*If not, why not?*	In our view, ASIC's proposed modifications do not enhance or achieve any of the stated purposes of Chapter 6 as it relates to the Regulated Transaction. Rather the modifications seek to extend the operation of Chapter 6 of the Corporations Act beyond its stated terms by penalising the use of custodian structures where it has the effect of avoiding the application of Chapter 6 that does not properly apply. In this way, the proposed use of section 655A can be seen as an attempt to modify section 113 and section 602 of the Corporations Act which ASIC is not empowered to modify. Even if ASIC does consider the modifications to be within the power granted by section 655A, we submit that there is no benefit in legislating against the use of an Australian unlisted public company with a custodian to offer stub equity for a number of reasons because the risks and consequences can be adequately disclosed in the relevant disclosure document and the negative consequences of the proposed modification B2 are potentially significant for the reasons set out below. Based on our experience of advising private equity clients, we believe there is no reasonable expectation that the proposed modifications will result in private equity firms utilising an Australian public company (governed by Chapter 6 of the Corporations Act) to make offers of stub equity. Overwhelmingly offers of stub equity as described in the proposal have been made by private equity acquirers in the context of a scheme of arrangement transaction. The purpose of such transactions is to take the ownership of the target entity into a private structure, allowing the private equity firm to take advantage of market opportunities for the business, to act swiftly and to have full control over decision-making during the life of the investment and in relation to exit. The likely practical result of the modifications put forward in the proposal is that, instead of offering stub equity via a public company without a custodian, private equity firms may: • look to offer stub equity using vehicles incorporated in offshore jurisdictions instead of Australian public companies; • cease offering retail shareholders the corporate opportunity of electing to receive stub equity as consideration for their shares in a control transaction and simply make all-cash offers; or • to the extent the offer of stub equity cannot be achieved in a manner that also achieves the desired commercial outcomes in any given transaction, decide not to proceed with the relevant control transaction at all. ***Offshore vehicles*** We expect that one consequence of the proposed modifications would be that prospective private equity acquirers may use offshore entities that would not be subject to the Corporations Act, and in our experience the disclosure, periodic reporting and corporate governance requirements in those offshore

CP312 reference and proposal	ASIC question	Submissions / feedback
		jurisdictions (such as the Cayman Islands or Bermuda as utilised in previous transactions) are significantly less onerous than those obligations that would be applicable to an Australian public company with a custodian in place. To that end, we submit that the proposal will not, in practice, result in increased protection for retail shareholders in the context of stub equity transactions as it will not result in retail shareholders being offered stub equity in a vehicle that is subject to Chapter 6 of the Corporations Act. ***Ceasing to offer retail shareholders the opportunity to elect to receive stub equity*** Another likely outcome of the proposal is that, where using an offshore vehicle is not desirable, private equity firms may cease offering stub equity, thereby removing the corporate opportunity for retail shareholders to elect to remain invested in businesses following a control transaction. Typical stub equity transactions have a default all-cash option which applies to all shareholders in lieu of a shareholder actively electing to receive the stub equity by returning an election form to the share registry. To that end, it is not possible for a shareholder to be “forced” into taking stub equity – an active election must be made by the relevant shareholder who has the benefit of detailed disclosure in the relevant disclosure document around the risks and consequences associated with electing to receive stub equity and the custodian structure.[1] In the context of a scheme of arrangement, ASIC has the ability to input into the content and nature of such disclosure via its statutory review period set out in section 411(2) of the Corporations Act. We do not agree with comments at paragraphs 30-35 of CP312 which outline that there are concerns with this structure “*…irrespective of whether the securityholders are provided with adequate disclosure in connection with their decisions to invest”.* The proposal has the effect of implying that retail shareholders are not able to make a decision about their investment for themselves based on the contents of a disclosure document, which seems counterintuitive having regard to the purpose of such documents. ***Not proceeding with a control transaction*** Stub equity is generally considered the only way to structure a public to private transaction that allows significant shareholders the opportunity to roll into the bidding vehicle in a tax efficient manner whilst still enabling their votes to count towards the applicable approval thresholds. Accordingly, a private equity acquirer may decide not to pursue a control transaction with a target company at all because it is no longer

[1] See, for example, sections 10.3(d) and 11.4 of the Greencross Limited scheme booklet (2018).

CP312 reference and proposal	ASIC question	Submissions / feedback
		able to do so in a manner which achieves the desired commercial outcomes. This could have the impact of depriving shareholders from an opportunity to realise value for their shares.
	Question B2Q2: *Should particular types of custodian arrangement or securityholder agreement be excluded from the proposal? If so, please explain why.*	As outlined in our response to Question B2Q1, we submit that the proposal should not restrict custodian arrangements and securityholder agreements in stub equity transactions provided there is adequate disclosure in relation to the risks and consequences of electing to receive stub equity. As expressed in our response to Question B1Q1, we do not object to the requirement that stub equity offers be made by a public company.
	Question B2Q3: *Are there any modifications to the proposal which may address unintended consequences of restricting the use of mandatory custodian arrangements and securityholder agreements in this way? Could these be addressed by including further modifications or individual relief?*	See response to Question B2Q1.
	Question B2Q4: *Do you have any other comments on the form of the proposed legislative instrument in so far as it modifies Ch 6?*	See response to Question B2Q1.