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Imitation Food In An Imitation Kitchen by Laura Oczosty

THE HARD CASE OF JAMES HARDIE AND WHAT'S NEXT FOR ASX

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"This is fundamentally not in the spirit of the law or the listing rules. It's basically treating Australian shareholders with contempt."

This was the chorus of a group of Australia's largest investors following James Hardie's April announcement of its (now complete) merger with Azek and proposed move to a primary listing on the NYSE. The target of this investor backlash was ASX, criticised for its apparent penchant for granting waivers to facilitate 'terrible deals' at the expense of local shareholders. Investors argued against ASX facilitating cross-border scrip-for-scrip deals that dilute Aussie holdings or shift the company's centre of gravity offshore.

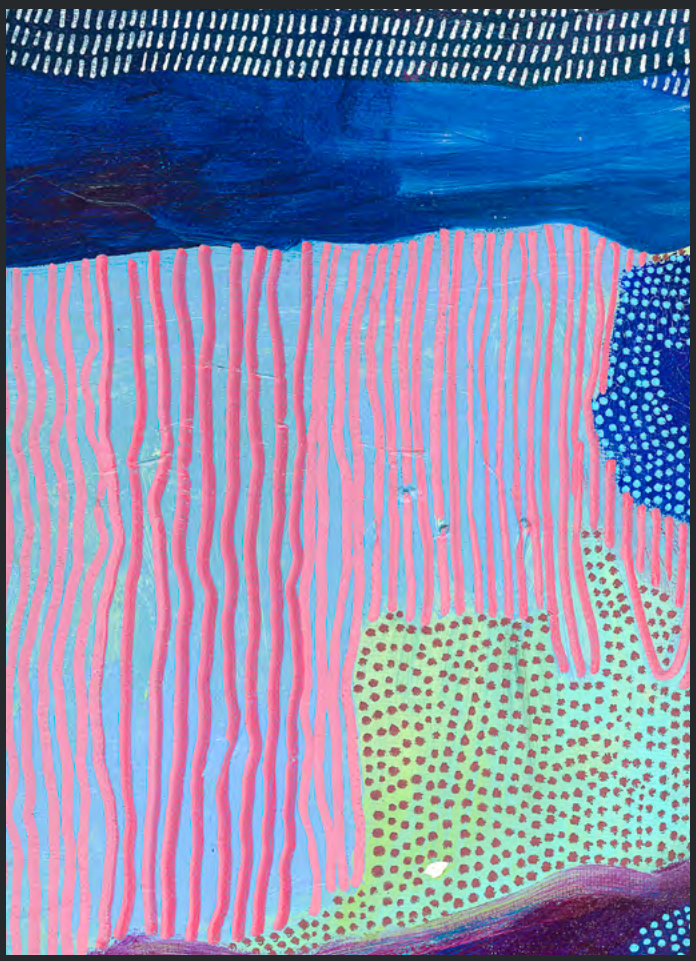
WHERE ARE WE NOW?

No knee-jerk changes have yet been made to the ASX Listing Rules or Guidance Notes. ASX is taking a measured approach to the feedback. It has just completed roundtable consultation with those same investors, with three key themes seemingly up for discussion:

1. lowering the threshold at which cross-border scrip-for-scrip deals will require shareholder approval
2. retesting shareholder approval requirements for 'significant' transactions under the ASX Listing Rules
3. requiring that dual-listed entities - presumably of any kind (whether Foreign Exempt Listings or a dual-listing in the 'primary' sense) - obtain the approval of shareholders before they are permitted to drop their ASX listing

ASX will issue a consultation paper with more details in coming months, with rule changes (if any) or updated guidance to follow in a year or so. KWM will prepare a submission and we welcome your ideas – please get in touch!

In the meantime, let's get some scene-setting points straight: ASX does a fantastic job at regulating our market. Its Listing Rules and Guidance Notes are, by global standards, generally transparent and clear. And credit to ASX for listening to investor feedback and initiating this consultation process. Second, a lot of noise was made in relation to a couple of issues which were legally clear, as we'll explain below. And, third, James Hardie is a pretty uncommon ASX-listed case. Sure it is listed on ASX, but it isn't an Australian public company and its ASX primary listing had been accompanied by a secondary listing on NYSE for over two decades – the result of various complex cross-border transactions and redomiciling which had already been approved by shareholders. Should one relatively unique deal trigger a rewriting of the rules?



WHAT DO THE ASX LISTING RULES SAY? (AND DID THE DEAL COMPLY?)

While it may not have been consistent with the antagonists' media narrative, the ASX Listing Rules and Guidance Notes on deals like James Hardie are pretty clear, the result of considerable market consultation and careful, incremental improvement. In summary:

- Scrip-for-scrip issuance: As it is, under Chapter 7 of the ASX Listing Rules, listed entities can issue up to 15% of their equity capital without securityholder approval, and even more in the context of an Australian takeover or scheme, unless it amounts to a 'reverse takeover' (ie one where the bidder issues 100% or more of their existing equity securities under, or to fund, the bid or scheme). This is backed up by our general law, which (at least for Australian companies) did away with authorised capital concepts some time ago, vesting considerable discretion in directors to raise and apply capital in the best interests of the company. ASX's Guidance Note on Chapter 7 has said for some time that ASX will consider granting a waiver to extend the Australian takeover/scheme exception to a listed entity making a takeover offer or merging with a foreign company or trust provided that it satisfies ASX that the deal is subject to an applicable regulatory regime equivalent to the Corporations Act. A further note in ASX's guidance makes it clear that ASX has previously granted waivers in relation to cross-border deals involving the US, UK, Canada and New Zealand, amongst other jurisdictions.
- Company transforming deals: Under Chapter 11, an ASX listed entity can also acquire a business or merge with one without its shareholders agreeing to it, provided the transaction does not constitute a significant change in the nature or scale of existing activities or a disposal of the main undertaking. ASX guidance confirms that shareholder approval is required for certain 'back door' listings as well as abandonment of a listed entity's main undertaking, and clear quantitative and qualitative criteria exist for determining whether deals may result in significant changes. Doing a controversial or bad deal is not a reason for ASX to require a shareholder vote.
- De-listings: The Listing Rules state that a listed entity may ask ASX to remove it from the ASX official list at any time, but ASX is not required to act on the entity's request for removal and may require conditions to be satisfied. Again, ASX's Guidance Note sets out clear criteria and notes that it some cases approval of security holders may be required before an entity can be removed from listing on ASX.

Investors may legitimately choose to debate the deal's commercial rationale, but criticism of its conformity with the ASX Listing Rules is not well-founded.

HOW DOES ASX APPLY ITS LISTING RULES?

Overall, when it comes to the ASX Listing Rules and investor protection, it's always about disclosure, dilution or changing the investment case mid-hold; and the latter two trigger a say by shareholders only if it crosses acceptable thresholds. Otherwise, ASX is largely seen as a facilitator of public markets, not a regulator. And that's an important distinction. It's also why many of ASX's rules bring with them a potential for exercise of ASX discretion and a clear rule of interpretation that speaks to both the spirit and the intention of the rule in question – all of which can work in favour of that facilitation, or equally against it. In our experience, ASX carefully weighs up the commercial imperatives of a transaction with its role in protecting investors (against both dilution and a bait-and-switch to their investment case) when determining how to apply the Listing Rules and whether to invoke its discretions. And, as we have noted above, ASX's guidance notes are by in large clear.

Is it ASX who should be more prescriptive and restrictive in its rules of engagement (as the James Hardie investors would say)? Is it for our corporate and securities laws to reset the dynamic between directors and shareholders by adding more tools to the activist toolkit? Or is it simply a case of applying the existing laws and policy settings in a manner that (chooses to) read the room?

James Hardie and Azek exemplifies the tension here: by treating the Delaware-governed US merger as if it were an Australian scheme proposal under Part 5.1 of our Corporations Act, ASX allowed James Hardie to issue about 35% of its issued shares to Azek shareholders without existing shareholders having a say, leaving many feeling sidelined. But, let's be clear: that decision by ASX was entirely in line with its Guidance Note and previous deals. You wouldn't have had to look much further than BHP's bid for Anglo or REA's bid for Rightmove to see how ASX-listed entities attempt outbound M&A without shareholder approval.

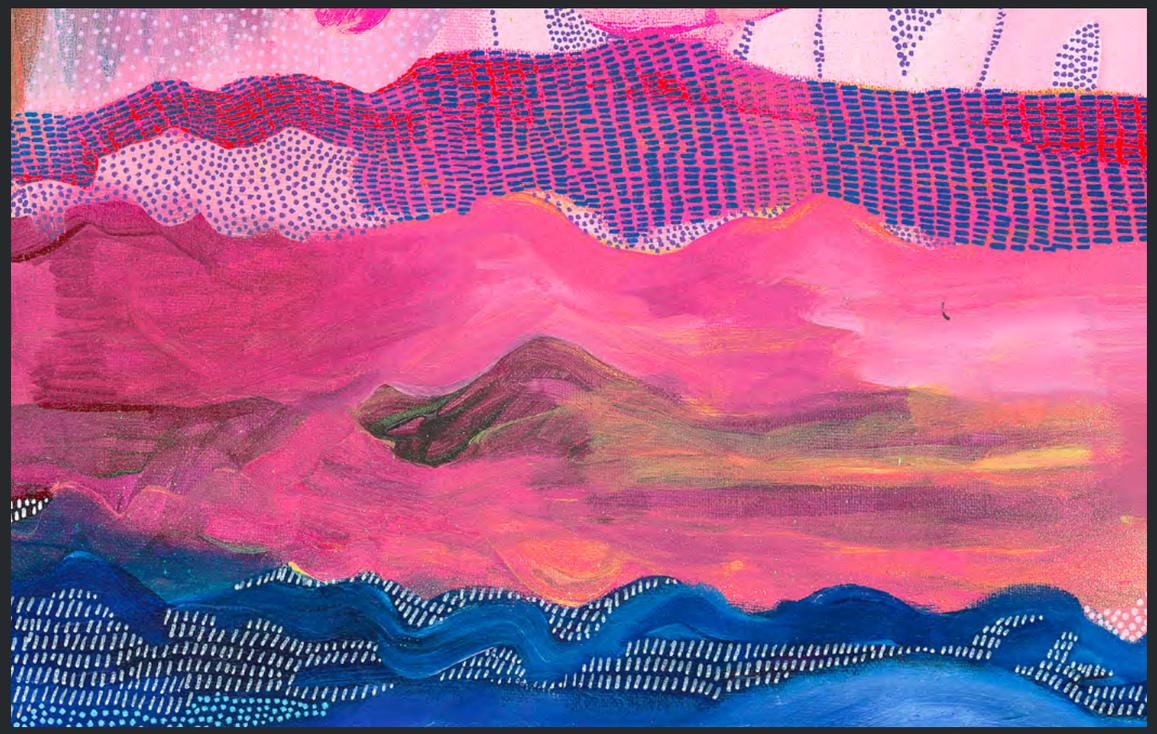
And it's hard to say whether James Hardie's investors would have been quite as outraged if the 'terrible deal' involved acquiring an Australian target and a Corporations Act-governed transaction; but there would have been no need for an ASX waiver if it did…

HOW DID JAMES HARDIE PLAY OUT?

ASX's decision to grant the waiver to James Hardie was justified because there was a comparable regulatory regime governing its merger with Azek, one that ASX could relate to, in the US and one which ASX had stated clearly in its Guidance Note was a jurisdiction in respect of which ASX had previously granted waivers. Put another way: it isn't for ASX to second-guess the SEC or the Delaware Courts, any more than it is for it to second-guess the role of ASIC or the Australian Courts in regulating Part 5.1 merger schemes; so why insist on a shareholder approval requirement?

But what of Chapter 11? It's really just a means of ensuring that the investment narrative told and sold – at the outset of an entity's life on ASX and developed since - is consistent with material corporate actions that are later pursued by the entity, and does not require the hand brake to be applied by shareholders or by ASX (from a suitability for listing perspective) before directors get carried away.

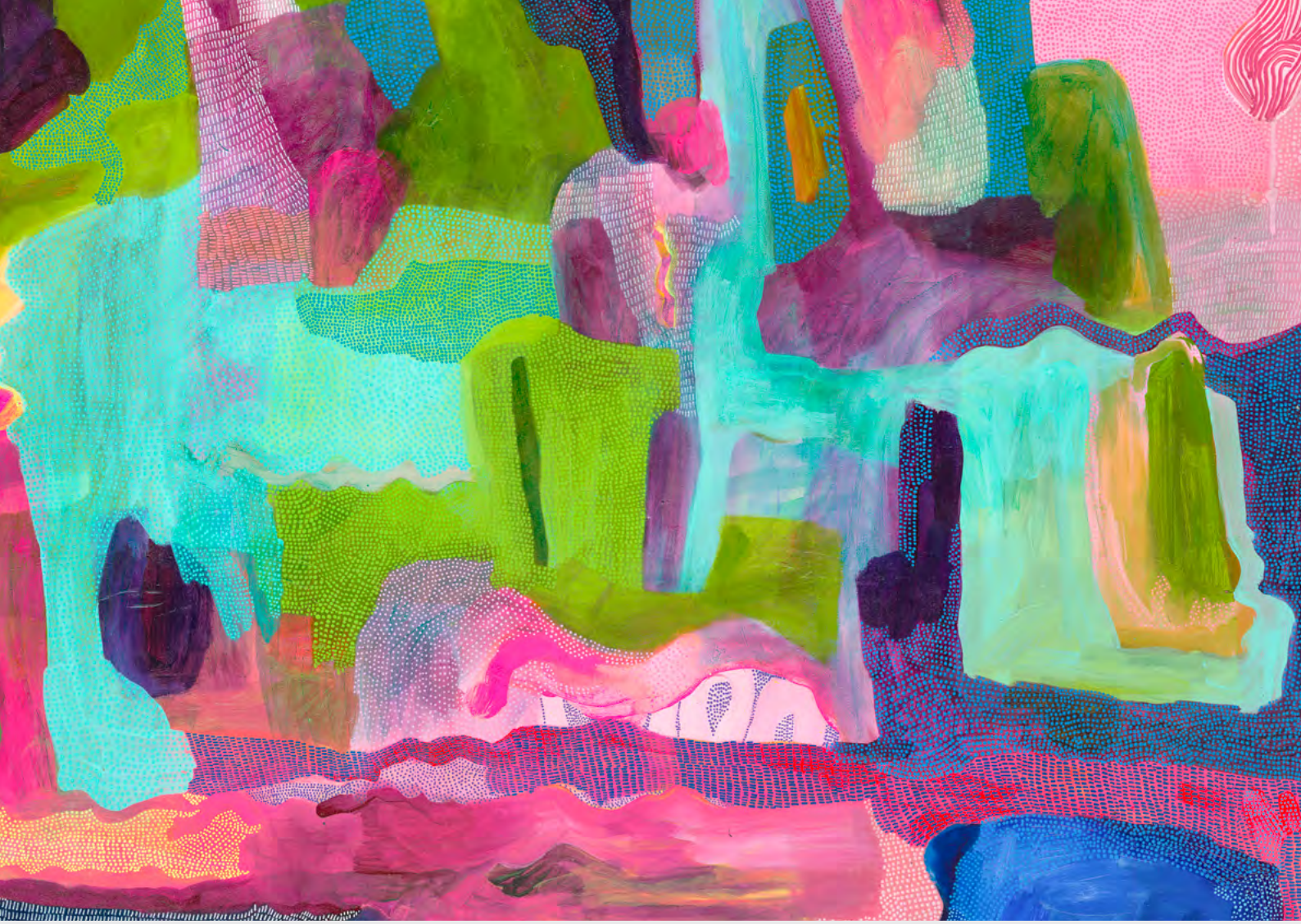
We've negotiated enough cross-border mergers to know that if a bidder requires its own shareholder approval – especially in a competitive or contested scenario – it can seriously undermine deal certainty and potentially derail an otherwise superior proposal for shareholders. It often comes with demands for a supersized reverse break fee, even where there are common shareholders between bidder and target and a potential for coercion that would make the Takeovers Panel balk (if you tried it with an Australian target). Admittedly, the 100% reverse takeover threshold – which is the ultimate no-go in Chapter 7 of the ASX LRs – already more permissive than in the US or the UK. But a 2017 ASX review of that did not seem to invite the same push for change as James Hardie provoked…



WHERE TO FROM HERE?

Regulatory oversight of dealmaking continues to increase, and there are some meaningful reasons to accept that. But introducing additional shareholder approval requirements or lowering the threshold at which directors must defer to shareholders is not regulatory oversight. At its worst, it's delegating complex decisions to a disparate and oft misaligned group (of individuals, corporates and funds), each with their own interests and varying abilities to digest increasingly voluminous materials . That's not to say that shareholder approval – for the bidder – doesn't have its place, even when not strictly required but otherwise appropriate. A well-functioning and advised board should always consider whether a transaction is so transformative (for a bidder) that it ought to be considered by the owners of the bidder too, and a strong investor relations culture will ensure that these considerations are worked through regardless of what the law, the regulators or the facilitators have to say.

But let's not change the Listing Rules, Guidance Notes or wave goodbye to ASX waivers – or a board's ability to execute - because of one contentious deal.



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