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How ASX should respond to James Hardie ordeal

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ASX and the board of James Hardie have faced uproar in recent weeks over the Azek deal, with James Hardie having agreed to issue 35 per cent of its shares as scrip consideration to acquire the Delaware company without sending the transaction to a shareholder vote.

The outrage extended to business journalists, including this masthead's esteemed columnist, John Durie, who described James Hardie's move as a blatant ploy "to avoid shareholder scrutiny".

Without rehashing what has already been said and written about the debacle, it's well worth considering how the ASX might make good on its commitment to review the listing rules in the aftermath of the backlash.

The focus of the ASX's review – and the mechanism to avoid shareholder approval in the Azek deal – is an exception to ASX Listing Rule 7.1 permitting an ASX entity to issue shares in excess of its 15 per cent annual placement capacity in connection with a takeover or scheme of arrangement.

In the context of the deal, the

The most compelling argument for the exception to remain (in some form) is for the ASX to be competitive with other exchanges. Why take this allowance away from ASX entities and give them another reason to dash off to other exchanges? Rather, keep the exception and avoid putting ASX entities at a competitive disadvantage to oversees peers.

Of course, the rules must acknowledge the real and drastic effect of the exception, in that it shifts the decision to proceed with a transformative scrip bid from the bidder's shareholders to the target's shareholders. Stricter guardrails must be introduced (indeed, the current ceiling of a reverse takeover is obviously far too high).

Shareholder approval under Listing Rule 7.1 is a cornerstone protection for material and dilutive share issues. James Hardie's shareholders are justifiably disgruntled at this transformative deal being agreed without their input. If we must pick an arbitrary point for where the exception should settle post-review, 20 or 25 per cent to match other jurisdictions seems reasonable. This would provide ASX entities with up to an additional 10 per cent against its already existing 15 per cent annual placement capacity for its M&A tool box.

The challenge to the ASX is to ensure its review manages to strike the right balance between commerciality and investor

ASX followed its existing precedent to grant a waiver to extend the exception to what it deems to be an equivalent foreign transaction (being, a statutory merger in the state of Delaware).

The exception and accompanying waivers granted by the ASX are not entirely without merit. As has been highlighted, the ASX guidance justifies the exception by reference to the difficulties that ASX entities may face completing transactions subject to shareholder approval for share issues.

In competitive processes involving listed and unlisted bidders, a competitive imbalance may result (the latter not being subject to the same requirement for shareholder approval for share issues). But the ASX justification is unconvincing.

In our experience, shareholder approval is not a showstopper, or even overly onerous in many deals – especially where the deal stacks up. And listed bidders are advantaged in other ways against unlisted entities – the prospect of issuing liquid scrip is a sound step towards levelling the playing field with privately funded bidders.

Even if shareholder approval is required, it shouldn't matter if an entity's bid is the superior bid (and any risk this poses can be tempered through existing mechanisms, like break fees).

protection. Provide ASX entities with the ability to compete with unlisted bidders in auction processes but preserve and protect the shareholder vote on material acquisitions involving the issue of scrip.

We have been involved in transformative deals where the board could circumvent shareholder approval, through waiver or exception, but has ultimately decided not to, given the materiality. That boards are having to make these choices at all can be seen as a red flag. They represent the proverbial canary in the coalmine, indicating a divergence between good corporate governance and the ASX listing rules – a clear signal that change is needed.

So, while ASX entities shouldn't be stripped of an important weapon in their arsenals, they should deploy it appropriately and with due regard to the interests and views of shareholders. Despite the explosive reaction to the Azek deal, it doesn't mean the ASX has abrogated its responsibility to safeguard investors. But those in charge of reviewing the listing rules have their work ahead of them in achieving the delicate weighting of ASX entities' commercial needs against the exchange's fundamental task of investor protection.

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