

Takeovers Legal Update

In this update

- Franked dividends in takeover bids 1
- Rights Issues can be very frustrating! 3

Franked dividends in takeover bids

WHAT YOU NEED TO KNOW

- Significant value can be given to target shareholders by the payment of a franked dividend as part of the bid consideration.

WHAT YOU NEED TO DO

- Be aware of the scope for franked dividend consideration and constraints on its availability.

It is not unusual in takeovers for a target company to pay a "special" dividend, with the support of the bidder, effectively as part of the bid consideration. That dividend is typically either partially or fully franked. Franked dividends can be an attractive tool for bidders to "sweeten" takeover bids. The payment of a franked dividend can add significant value to target shareholders, particularly Australian resident shareholders.

Recent transactions such as DuluxGroup Limited's protracted takeover of Alesco Corporation Limited (announced in May 2012) (Alesco Transaction) and Archer Daniels Midland's (ADM's) bid for GrainCorp (announced in May 2013) highlight the scope for franked dividends in the context of takeover bids to increase the total value of the consideration offered to target shareholders. The Alesco Transaction (discussed in our 2 October 2012 [Takeovers Legal Update](#)) involved a dispute before the Takeovers Panel in relation to the inclusion of franking credits (and the value ascribed to the franking credits) in the headline consideration. The recommended takeover offer for GrainCorp by ADM will involve GrainCorp shareholders receiving \$13.20 per share, comprising a cash payment of \$12.20 and fully franked dividends totalling \$1 per share. The announcement that the GrainCorp Board was recommending the ADM offer indicates that the fully franked dividends will provide

up to an additional 43 cents per share to shareholders that can fully utilise the franking credits.

Where a fully franked dividend is proposed, bidders need to ensure that Australia's complex tax laws have been complied with to ensure that the franking credits and the associated offsets can in fact be utilised by the target shareholders.

Some of the key Australian tax issues that need to be considered by the bidder include:

- Whether franking credits are available to frank a dividend. For example, there are complex rules whereby franking credits of entities that are substantially wholly-owned (95%+) by tax exempt (eg non-resident) entities may generally only be used to eliminate withholding tax for non-resident shareholders and therefore are of limited use for resident shareholders;
- Complex "qualified person" rules that are essentially aimed at preventing trading in franking credits. In order to take advantage of franking credits, a shareholder must be a "qualified person". The qualified person rules have a "45 day rule" and a "related payment rule". Basically, subject to some carve outs (eg the rules may not apply to small shareholders with franking credit offsets of less than \$5,000), the rules require that the target

shareholder must have held the relevant target shares "at risk" for a continuous period of at least 45 days (excluding the days of purchase or disposal of the target shares). The precise times at which the 45 day period is tested depends on the circumstances; and

- Whether the Commissioner of Taxation (Commissioner) could make a determination under the franking credit streaming provisions or the anti-avoidance rules in the Tax Act in relation to the franking credits attached to the dividends paid.

Because of the application of the above franking rules, it is common for bidders to obtain class rulings from the Commissioner to confirm the Australian tax issues discussed above. This often takes up to 3 to 4 months and accordingly the timetable implications will need to be considered if the deal (or a recommendation) is to be conditional on a class ruling.

Contacts



Ian Kellock
Partner
Melbourne
T: +61 3 9679 3075
E: ian.kellock@ashurst.com



Tim Loh
Senior Associate
Melbourne
T: +61 3 9679 3076
E: tim.loh@ashurst.com

Rights Issues can be very frustrating!

WHAT YOU NEED TO KNOW

- The Panel prevented a target proceeding with a rights issue that would breach a bid condition without first obtaining shareholder approval.
- The Panel suggested it may be prudent for a target to first approach a bidder before undertaking a rights issue that may frustrate the bid.

In *World Oil Resources Limited*, the Takeovers Panel considered whether a rights issue by World Oil, an ASX listed company, was a frustrating action in relation to a takeover bid for the company. The bid was conditional on, among other things, prescribed occurrences, including that World Oil would not issue or agree to issue shares. Approximately two weeks after the bid was announced, World Oil announced a 1-for-2 non-renounceable rights issue which was not subject to shareholder approval. The issue price for the shares under the rights issue was the same price as the bid price. Perhaps not surprisingly, the Panel found that the rights issue was a frustrating action in relation to the bid and resulted in unacceptable circumstances.

The Panel noted that the rights issue was not subject to shareholder approval or any other mechanism that minimised the potential for the rights issue to frustrate the bid. Nor did the announcement for the rights issue disclose that the issue of shares under the rights issue would trigger a condition of the bid. Furthermore, the announcement did not include a comparison of the relative merits of the rights issue and the bid.

The Panel confirmed that where an action by a target is likely to trigger a material condition of the bid, the Panel will generally require that shareholders be given a choice between a frustrating action and the takeover bid, for example, by asking shareholders to approve the frustrating action. The Panel considered that World Oil should have made the rights issue subject to shareholder approval, and ordered that it not proceed with the rights issue without shareholder approval. It also ordered that World Oil include in the notice of meeting (among other things):

- a comparison of the financial position of World Oil if the rights issue is approved and if it is not approved;
- a description of the takeover bid; and

- a statement that approval of the rights issue will result in the bidder being entitled not to proceed with its bid.

The Panel noted that, in considering whether a frustrating action gives rise to unacceptable circumstances, it is guided by the conditions surrounding the bid and the conditions surrounding the frustrating action, including, most relevantly in this matter:

- whether the condition is commercially critical to the bid;
- whether it is unreasonable for a bidder to rely on the condition;
- how advanced the negotiations on the frustrating action were when the bid was announced; and
- whether there is commercial imperative for the frustrating action.

The Panel considered that an issue of new shares, if significant in the context of the target's issued capital, is an example of an action that may give rise to unacceptable circumstances. As the rights issue would have resulted in an issue of 50% of World Oil's issued capital, it considered this to be significant and commercially critical to the bid.

World Oil submitted that it had already taken substantial steps in preparation for the rights issue prior to announcement of the takeover bid. It also submitted that the rights issue was not made with the intention to frustrate the bid, but rather that the decision to continue with the rights issue was due to the pressing financial circumstances of World Oil. However, the Panel considered that there had been an opportunity to seek shareholder approval before undertaking the rights issue, and there was insufficient material to show that this would necessarily have had a deleterious effect on World Oil's financial circumstances.

Interestingly, the Panel also noted that at no point following the announcement of the bid and before the announcement of the rights issue did any director or other representative of World Oil approach the bidder in relation to its bid condition that would be triggered by the rights issue. The Panel said that it would not necessarily expect the target in a stressed financial position to approach a hostile bidder as its first contact. It noted that such a target may have other options for raising capital that would not frustrate the bid or potential bid. However, the Panel went on to say that, where that is not the case, in its view "*it would be prudent to first approach the bidder before undertaking the corporate action that may frustrate the bid or potential bid*".

Following the announcement of the rights issue, the bidder offered to subscribe for shares in World Oil by way of placement at the issue price under the rights issue. It also offered World Oil an interest free loan for six months, convertible at the election of World Oil into shares at the issue price under the rights issue. World Oil did not consider these funding options to be satisfactory. The Panel said, however, that had World Oil approached the bidder prior to announcing the rights issue, options such as those offered by the bidder may have been made available and may have preserved the ability for shareholders to choose between the rights issue and the bid. The Panel said that "*[t]here may be good reasons not to accept an offer of funding, but there are unlikely to be good reasons not to even allow consideration of one.*"

Association issues

The Panel also found that certain shareholders in World Oil were associates and that purchases were undertaken in breach of section 606 of the *Corporations Act* and made a declaration of unacceptable circumstances. The Panel ordered that the shares above 20% held by the associated shareholders be vested in and sold by ASIC.

The reasons for this decision included a detailed analysis of why the Panel considered that the relevant shareholders were associates of each other. Following the decision in *Mount Gibson Iron Ltd*, it examined whether there was:

- a shared goal or purpose;
- prior collaborative conduct;
- structural links;
- common investments and dealings; and
- common knowledge of relevant facts,

as between or by the relevant shareholders.

The Panel drew inferences from patterns of behaviour, commercial logic and other evidence suggestive of association to conclude that an association existed.

The Panel's finding of the existence of an association in World Oil may be contrasted with the recent decision in *Winpar Holdings Ltd*. In *Winpar Holdings*, the applicant (National Exchange Pty Ltd) had submitted that a placement of shares in Winpar was made to associates of directors of Winpar and had the effect of increasing their combined holding from 28.48% to 34.15%. The Panel considered that there was no reasonable prospect that it would declare these circumstances to be unacceptable and declined to conduct proceedings. The Panel considered that the applicant had not provided sufficient material to support the submission of association, or convince it that such material exists to support its application. It said that to conduct proceedings, it would need to see, for example, material in support of some or all of further structural links, a shared goal or purpose in relation to Winpar, prior collaborative conduct, other common investments and dealings and common knowledge of relevant facts and/or uncommercial actions. The Panel confirmed (following the *Mount Gibson* decision) that it is for the applicant to demonstrate a sufficient body of evidence of association and to convince the Panel as to that association, albeit with proper inferences being drawn.

Contacts



John Sartori
Partner
Melbourne
T: +61 3 9679 3562
E: john.sartori@ashurst.com



Kylie Lane
Senior Associate
Melbourne
T: +61 3 9679 3421
E: kylie.lane@ashurst.com

Abu Dhabi

Suite 101, Tower C2
Al Bateen Towers
Bainunah (34th) Street
Al Bateen
PO Box 93529
Abu Dhabi
United Arab Emirates
T: +971 (0)2 406 7200
F: +971 (0)2 406 7250

Adelaide

Level 4
151 Pirie Street
Adelaide SA 5000
Australia
T: +61 8 8112 1000
F: +61 8 8112 1099

Beijing

Level 26, West Tower, Twin Towers
B12 Jianguomenwai Avenue
Chaoyang District
Beijing 100022
PRC
T: +86 10 5936 2800
F: +86 10 5936 2801

Brisbane

Level 38, Riverside Centre
123 Eagle Street
Brisbane QLD 4000
Australia
T: +61 7 3259 7000
F: +61 7 3259 7111

Brussels

Avenue Louise 489
1050 Brussels
Belgium
T: +32 (0)2 626 1900
F: +32 (0)2 626 1901

Canberra

Level 11
12 Moore Street
Canberra ACT 2601
Australia
T: +61 2 6234 4000
F: +61 2 6234 4111

Dubai

Level 5, Gate Precinct Building 3
Dubai International
Financial Centre
PO Box 119974
Dubai
United Arab Emirates
T: +971 (0)4 365 2000
F: +971 (0)4 365 2050

Frankfurt

Operturm
Bockenheimer Landstraße 2-4
60306 Frankfurt am Main
Germany
T: +49 (0)69 97 11 26
F: +49 (0)69 97 20 52 20

Hong Kong

11/F, Jardine House
1 Connaught Place
Central
Hong Kong
T: +852 2846 8989
F: +852 2868 0898

Jakarta (Associated Office)

Oentoeng Suria & Partners
Level 37, Equity Tower
Sudirman Central
Business District
JI. Jend. Sudirman Kav. 52-53
Jakarta Selatan 12190
Indonesia
T: +62 21 2996 9200
F: +62 21 2903 5360

Jeddah (Associated Office)

Level 9 Jameel Square
Corner of Talhia Street and
Al Andalus Street
PO Box 40538
Jeddah 21511
Saudi Arabia
T: +966 (0)2 283 4135
F: +966 (0)2 283 4050

London

Broadwalk House
5 Appold Street
London EC2A 2HA
UK
T: +44 (0)20 7638 1111
F: +44 (0)20 7638 1112

Madrid

Alcalá, 44
28014 Madrid
Spain
T: +34 91 364 9800
F: +34 91 364 9801/02

Melbourne

Level 26
181 William Street
Melbourne VIC 3000
Australia
T: +61 3 9679 3000
F: +61 3 9679 3111

Milan

Via Sant'Orsola, 3
20123 Milan
Italy
T: +39 02 85 42 31
F: +39 02 85 42 34 44

Munich

Ludwigpalais
Ludwigstraße 8
80539 Munich
Germany
T: +49 (0)89 24 44 21 100
F: +49 (0)89 24 44 21 101

New York

Times Square Tower
7 Times Square
New York, NY 10036
USA
T: +1 212 205 7000
F: +1 212 205 7020

Paris

18, square Edouard VII
75009 Paris
France
T: +33 (0)1 53 53 53 53
F: +33 (0)1 53 53 53 54

Perth

Level 32, Exchange Plaza
2 The Esplanade
Perth WA 6000
Australia
T: +61 8 9366 8000
F: +61 8 9366 8111

Port Moresby

Level 4, Mogoru Moto Building
Champion Parade
PO Box 850
Port Moresby
Papua New Guinea
T: +675 309 2000
F: +675 309 2099

Rome

Via Sistina, 4
00187 Rome
Italy
T: +39 06 42 10 21
F: +39 06 42 10 22 22

Shanghai

Suite 3408-10
CITIC Square
1168 Nanjing Road West
Shanghai 200041
PRC
T: +86 21 6263 1888
F: +86 21 6263 1999

Singapore

12 Marina Boulevard
#24-01 Marina Bay
Financial Centre Tower 3
Singapore 018982
T: +65 6221 2214
F: +65 6221 5484

Stockholm

Jakobsgatan 6
PO Box 7124
SE-103 87 Stockholm
Sweden
T: +46 (0)8 407 24 00
F: +46 (0)8 407 24 40

Sydney

Level 36, Grosvenor Place
225 George Street
Sydney NSW 2000
Australia
T: +61 2 9258 6000
F: +61 2 9258 6999

Tokyo

Shiroyama Trust Tower
30th Floor
4-3-1 Toranomom, Minato-Ku
Tokyo 105-6030
Japan
T: +81 3 5405 6200
F: +81 3 5405 6222

Washington DC

1875 K Street NW
Washington, DC 20006
USA
T: +1 202 912 8000
F: +1 202 912 8050

This publication is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects of those referred to. Readers should take legal advice before applying the information contained in this publication to specific issues or transactions. For more information please contact us at aus.marketing@ashurst.com.

Ashurst Australia (ABN 75 304 286 095) is a general partnership constituted under the laws of the Australian Capital Territory carrying on practice under the name "Ashurst" under licence from Ashurst LLP, a limited liability partnership registered in England and Wales. Further details about the Ashurst group can be found at www.ashurst.com.

© Ashurst Australia 2013. No part of this publication may be reproduced by any process without prior written permission from Ashurst. Enquiries may be emailed to aus.marketing@ashurst.com. Ref: 652584413.02 22 May 2013