FRANKING DIVIDENDS IN TAKEOVERS AND SCHEMES

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Legal Briefings – By **Rodd Levy**

SUMMARY

- The CIMIC bid for Sedgman raised the issue of whether a bidder can reserve the right to deduct a 'reasonable value' of franking credits attached to a dividend.
- The target (and ASIC) claimed this gave rise to unacceptable circumstances.
- Confronted with this argument, CIMIC withdrew the provision, potentially setting a new market practice.

DEDUCTING THE VALUE OF FRANKING CREDITS

For some time there has been controversy about the practice of bidders reserving the right to deduct from the offer consideration the value of franking credits attached to dividends paid by a target company during the offer period.

Typically, offer terms have provided that the bidder may deduct the cash value of dividends plus the value of franking credits "as reasonably assessed by the bidder". These clauses have been around since the inception of the dividend imputation system in the 1980s.

The idea behind this clause is to protect the bidder from any material diminution in the value of the target company which may be attributed to the paying out of franking credits held by that company. It is the value to the bidder (not to the shareholder) which would be relevant.

Despite the long history of these clauses being included, we are not aware of any instance where a bidder has actually sought to rely on this provision and reduce its offer price for the value of franking credits paid out during a bid period. Yet the provisions have remained common.

In recent years, the practice of including this provision has been under scrutiny and it has been suggested that including such a provision may give to rise “unacceptable circumstances” because it is uncertain how the bidder would value the franking credits.

This led to the Takeovers Panel issuing a draft guidance note in 2014 which proposed to set out some rules dealing with this situation. After a period of public consultation, however, the matter was not pursued as the Panel felt it would be better to deal with the matter in a live matter, rather than by theoretical submissions.

It now looks like the practice will cease given developments in CIMIC’s bid for Sedgman.

CIMIC’S BID FOR SEDGMAN

In this matter, CIMIC made an unconditional offer and included the standard clause reserving the right to deduct the value of franking credits “as reasonably assessed by CIMIC” should a franked dividend be paid during the offer period.

The target company, Sedgman, claimed this gave rise to uncertainty and took the matter to the Takeovers Panel claiming it gave rise to unacceptable circumstances.

CIMIC had also announced that it would stand in the market and acquire shares at the offer price or less (in reliance on the on-market purchase exception in the legislation). Sedgman complained that this tended to force shareholders to sell on market to avoid the potential deduction of the value of franking credits and that this was coercive and against the policy of the law.

ASIC sided with Segdman. It said that the value of franking credits should not be deducted as that may disadvantage shareholders.

In response to the application, CIMIC issued a supplementary bidder’s statement saying that it would not seek to deduct any value attributable to franking credits if a franked dividend was paid during the offer period and it amended the offer terms to remove the provision.

In light of this, the Panel did not pursue the issue further. It did, however state that:

“In our view, the question of the legality of deducting the value of franking credits therefore remains an open question.”

COMMENTARY - IMPLICATIONS

To the extent that the legislation allows a bidder to deduct the value of a dividend paid during an offer, it must be the case that a bidder can also deduct the value of attached franking credits.

However, leaving aside that technical point, the Sedgman application will heighten the risk that any bidder who seeks to reserve the ability to deduct for franking credits going forward is asking for a fight.

It is conceivable that the point could be avoided by the bidder specifying how the franking credits would be valued to it. It could state, for example, that it will deduct 50 cents in the dollar for franking credits (and give some explanation as to how it decided on that sum).

We do not expect that this will become common practice, unless the franking credits are so significant and there is a real risk that paying out a dividend will diminish the value of the target company materially in a way that cannot be predicted by any other condition (such as a condition that the target company not pay any dividends during the offer period).

MORE INFORMATION

For information regarding possible implications for your business, contact Rodd Levy.

KEY CONTACTS

If you have any questions, or would like to know how this might affect your business, phone, or email these key contacts.

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