

FUTURE OF STUB EQUITY - BACK TO THE CAYMAN ISLANDS?

28 June 2019 | Australia

Legal Briefings - By **Rebecca Maslen-Stannage and Alice Li**

Since ASIC's consultation paper surprised the market by raising a cloud of uncertainty over the use of public company custodian structures in stub equity arrangements, bidders are finding their safest stub equity havens are jurisdictions such as the Cayman Islands and Bermuda. We will be submitting to ASIC that retail shareholders are better protected by the use of public company custodian structures and encouraging ASIC not to rule them out.

IN BRIEF

- In January, we reported on ASIC's objection to the proprietary company custodian structure in the [Capilano scheme of arrangement](#).
- As [briefed in our recent alert](#), ASIC now contemplates a broader ban on stub equity control transactions which involve an Australian public company with a custodian arrangement.
- In practice, we are already seeing proposed bidders respond by proposing stub equity bid vehicles incorporated in low regulation countries such as the Cayman Islands and Bermuda.
- We will be submitting to ASIC that shareholders are better protected by the public company custodian structure.

STUB EQUITY

Stub equity deals are favoured by private equity bidders or acquirers as they provide: flexibility in the ownership structure, a potential reduction in the funding required and a mechanism for the bidder to exit smoothly from its investment. These deals also have the added benefit of providing target shareholders with the opportunity to retain an economic interest in the target and ride the private equity train to a future exit.

As mentioned in our [previous article](#), since the iProperty Group Limited (2015) transaction, we had previously seen a move away from foreign offshore vehicles from low regulation jurisdictions such as Bermuda or the Cayman Islands in stub equity deals and an increase in the use of unlisted Australian companies.

However, since Capilano, ASIC's opposition to the proprietary company stub equity custodian structure meant that the safest route for investors offering stub equity appeared to be the use of an Australian public company stub vehicle.

PROPOSED PROHIBITION ON CUSTODIAN ARRANGEMENT EVEN FOR PUBLIC COMPANIES

ASIC's consultation paper surprised the market however by also objecting to the Australian public company custodian structure. ASIC's proposed legislative instrument would prohibit the use of public company vehicles with a custodian arrangement in a stub equity transaction where, because the custodian structure keeps the number of shareholders below 50, the takeovers rules or disclosing entity provisions do not apply.

We accept from a retail investor's perspective that they might prefer to hold shares in a company subject to the takeovers rules. However, these stub equity structures arise from a scheme of arrangement or takeover bid, where the shareholders have already had the benefit of the takeovers rules to actually deliver them the stub equity they receive in the deal. From the bidder's perspective, it has already complied with the takeovers rule when offering the shareholders consideration in the stub equity vehicle.

ADDED COST AND COMPLEXITY WILL LIKELY ENCOURAGE A MOVE BACK TO FOREIGN STRUCTURES

A bidder could use an Australian public company vehicle with more than 50 members and be able to facilitate a full exit without being restricted by the takeovers rules, but that would involve some "clunky" structuring to give the bidder a relevant interest in all of the shares in the stub equity vehicles. It would add cost and complexity to a bidder who wants to deliver 100% ownership to a buyer on exit.

In light of the ASIC consultation paper, bidders would rather avoid that complexity and the regulatory risk as to whether ASIC might also object to that form of structure. Therefore, under transactions currently under negotiation, we see bidders moving back to the usage of Bermudan or Cayman Island structures.

RETAIL INVESTOR PROTECTIONS

Australian retail shareholders would generally prefer the familiarity of an Australian stub equity vehicle to a Bermudan or Cayman Island vehicle. Bermudan or Cayman Island vehicles do not provide shareholders with some of the safeguards of an Australian public company, including: restrictions on related party transactions, conflicted directors voting, rules for appointment and removal of directors, the requirement to have Australian resident directors, AGMs and periodic financial reporting.¹

In ASIC's efforts to preserve the safeguards afforded to shareholders in a public Australian company, the proposed legislative instrument would ironically either:

- drive the increase of foreign offshore vehicles without those safeguards; or
- remove the opportunity for retail shareholders to participate in investment opportunities, regardless of the fact that they may believe in the long term future of the company (or the particular sector) and understand the risk involved in such investment; and
- increase the complexity of private equity investors' exit and the overall costs of pursuing a control transaction.

NEXT STEPS

As noted in our earlier article, consultation is open until 17 July 2019. We welcome the opportunity ASIC is providing for submissions on this proposal. We will be making a submission to ASIC on these points and, for the reasons we have outlined, hope that ASIC decides not to ban the public company custodian structure in the context of stub equity transactions.

ENDNOTES

1. ASIC Consultation Paper 312 "Stub equity in control transactions" June 2019, at B14.

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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