INSIGHTS AND GUIDANCE ON ASIC'S REGULATORY FOCUS FOR PUBLIC M&A OVER THE SECOND HALF OF 2019

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Legal Briefings – By **Andrew Rich and Zoe Leyland**

We examine the final corporate finance report recently released by ASIC and provide commentary on the key trends and regulatory focus areas identified within. Although the report relates to the second half of calendar 2019 (and before the impact of COVID-19), it still provides interesting insights into ASIC's regulatory focus in the takeover and scheme space.

IN BRIEF

- Public M&A activity has increased, with 41 control transactions over the second half of 2019 (compared to 29 in the previous six month period).
- ASIC's regulatory focus in the public M&A space over the period has been on control transactions undertaken via schemes, and in particular to identify and address concerns about shareholder equality.
- Case studies of ASIC intervention in schemes have included matters relating to class issues, collateral benefits and the divestment of interests during the scheme process.
- ASIC has also continued to focus on the use of certain equity swap arrangements in the context of control transactions, taking action in a matter that resulted in a partial divestment of physical holdings and improved disclosure of equity derivative positions.

ASIC'S CORPORATE FINANCE REPORT

ASIC has released its bi-annual corporate finance report[1] summarising its corporate regulatory activity over the second half of 2019. The report includes key statistics and observations from its oversight of transactions over this period. Although the report relates to the second half of calendar 2019 (and before the impact of COVID-19), it still provides interesting insights into ASIC's regulatory focus in the takeover and scheme space.

This report will be the last report of its kind from ASIC as it will now shift to providing its corporate finance updates through quarterly newsletters.

We provide some of the public M&A highlights below.

OVERVIEW OF PUBLIC M&A ACTIVITY

Public M&A activity over the period was high. ASIC reported 41 control transactions over the final six months of 2019, compared with 29 in the previous period.

Some interesting observations from the period include:

- **Schemes continue to dominate:** There were more control transactions undertaken by way of scheme of arrangement than takeover bid, with 24 transactions undertaken by scheme and 16 by bid (plus one trust scheme). Consistent with previous trends, most of the transactions under A$50 million in value were undertaken by way of takeover bid.

- **Increase in M&A activity attributable to domestic offerors:** While the number of control transactions by overseas offerors was consistent with the previous period (13 compared to 14), there was a notable increase in the number by domestic offerors (28 compared to 15 for the previous period). While overseas offerors still represented 53% of all deal value, this was a notable decrease from 73% in the previous period.

- **Cash remains king**: The largest control transactions were offers of all-cash consideration, with all-cash offers making up 9 of the top 10 offers,[2] which has been a consistent theme over the past few years.

INSIGHT FROM ASIC'S ACTIVITY AND FUTURE AREAS OF FOCUS

Key areas of ASIC focus over the second half of 2019 were:

CLASS COMPOSITION AND FAIRNESS CONSIDERATIONS

ASIC reviewed a scheme implementation agreement and ancillary agreements that provided two entities associated with directors an opportunity to invest in a proposed joint venture into which assets of the target company were to be sold (conditional on the scheme being approved). The directors had refrained from making a recommendation to shareholders but proposed to vote in the same class as other shareholders.

ASIC's concerns in relation to voting in the same class, the equality principles and the prohibition on collateral benefits were allayed by:

- the director entities undertaking not to vote in favour in the same class as other shareholders; and
- full and frank disclosure of the arrangements in the scheme booklet.

COLLATERAL BENEFITS

ASIC provided a case study of a scheme proposed by an externally managed investment company where the target obtained an expert report that stated that a 'net benefit' was being given to three shareholders who held shares in the external manager. The benefit arose as the external manager had agreed to novate its management rights and provide certain transitional services to the acquirer for consideration.

Despite the expert's opinion, the target had not taken any pre-emptive steps to address these matters.

ASIC intervened and requested that two of the three shareholders enter into deeds poll providing that they would not vote any shares held in favour of the scheme. As the benefit to the other shareholder was likely immaterial to them relative to their shareholding in the target, ASIC requested that this shareholder's votes be tagged so that if they were determinative of the voting outcome, this could be considered by the court.

MARKET AND PROCEDURAL INTEGRITY

ASIC also emphasised its focus on not only the impact of disclosures, offer structuring and conduct on target holders, but also on the active market in which transactions are taking place.

DIVESTMENT DURING SCHEME PROCESS

The report included a case study of the divestment of interests during the scheme process in the Australian Unity Office Fund trust scheme, which we have previously written about here.

In this matter, ASIC submitted an application to the Takeovers Panel contending that the sale of a pre-scheme stake during that scheme was an intervention in the market that undermined the integrity of the trust scheme mechanism and did not allow all unitholders to have an equal opportunity in benefits offered under the scheme given the selective nature of the sale process (with units sold at a discount to the market price and to institutional clients of the acquirer's financial adviser).

Ultimately, the voting majority required to approve the scheme was not met and the scheme did not proceed. As a result, ASIC's application to the Takeovers Panel was withdrawn.

EQUITY DERIVATIVES AND TAKEOVER BID

During the period, ASIC continued to raise concerns about the use of certain equity swap arrangements in the context of control transactions and took action in a matter that resulted in a partial divestment of physical holdings and improved disclosure to the market in relation to swap positions held by a company's major shareholder.

POLICY UPDATES

The report noted that ASIC intends to release its response in the coming months to submissions received on its consultation paper on stub equity control transactions. As previously written about here, HSF has submitted that retail shareholders are better protected by the use of public company custodian structures in stub equity transactions and has encouraged ASIC not to rule them out.

CRIMINAL ACTIONS

ASIC also reminded market participants that contraventions of the Corporations Act in relation to a control transaction, or the acquisition of a substantial interest in shares, can result in criminal prosecution. It provided two examples of matters prosecuted by the Commonwealth Director of Public Prosecutions:

- Jan Cameron, a former director of Bellamy's, for her failure to properly disclose her interest in Bellamy's issued capital; and
- a Nowra man convicted and sentenced to two years' imprisonment on two counts of giving false and misleading information to ASIC in response to its inquiries about interests in shares in Northwest Resources Limited.

See our previous article on these matters here.

ENDNOTES

1. ASIC Report 659: ASIC regulation of corporate finance: July to December 2019.
2. For one cash deal, scrip was also issued to a separate class of scheme members. For another cash deal, an optional scrip consideration component was available to certain eligible shareholders.

KEY CONTACTS

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

ANDREW RICH
PARTNER, SYDNEY

+61 2 9225 5707
andrew.rich@hsf.com

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