HERBERT SMITH FREEHILLS

NEW TAKEOVER POLICIES ON FRUSTRATING ACTION, DIVIDENDS AND SUMMARIES IN TAKEOVERS DOCUMENTS

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Legal Briefings – By **Simon Haddy** and **Andrew Rich**

SUMMARY

- The Takeovers Panel is proposing changes to its frustrating action policy that would give targets more flexibility where a bid condition has already been breached but the bidder has effectively given itself a free exit option by declining to confirm whether it will rely on the breach to allow its bid to lapse.
- The Takeovers Panel is encouraging the inclusion, upfront in takeover documents, of a summary that is 'accessible to retail shareholders'. The proposed form of the summary is quite prescriptive.
- The inclusion in an announcement of the value of franking credits in a 'headline' offer price is likely to give rise to unacceptable circumstances.
- If a bidder wishes to retain the right to reduce the bid consideration by the amount of franking credits, it must clearly state how the deduction for franking credits will occur, either by a formula or as a fixed amount.

The Takeovers Panel has invited comments on its proposed revised Guidance Notes on 'Frustrating Action' and 'Takeovers Documents' as well as its proposed new Guidance Note on 'Dividends'. We discuss each of the proposed takeover policy reforms in this article.

FRUSTRATING ACTION

The Takeovers Panel has proposed amendments to its Guidance Note on frustrating action (GN 12) to address concerns that the policy had a potentially excessive effect on targets in some lengthy or contentious bids. If adopted, the changes would give target companies more flexibility where a bid condition has already been breached but the bidder has effectively given itself a free exit option by declining to confirm whether it will rely on the breach to allow its bid to lapse.

The frustrating action policy can have a significant effect on target companies during a hostile takeover bid as, in general, material transactions and initiatives – no matter how attractive or value-accretive – cannot be implemented by the target company without express approval from shareholders if they might cause a condition of the bid to be breached.

In general, the policy has worked well, and has ensured that target shareholders, rather than target boards, have the final say on whether a takeover bid succeeds.

The Takeovers Panel is now considering the situation where a bid condition has already been breached but the bidder has not disclosed whether it intends to rely on that breach to allow its bid to lapse – in effect, creating for itself a free exit option, where shareholders do not know whether the bid will proceed. In this situation, it is arguably unreasonable (depending on the circumstances) for the bidder to be entitled to constrain the target's ongoing activities via the frustrating action policy.

This concern is one which was identified by Herbert Smith Freehills in an opinion piece in The Australian in July last year.[1]

If adopted, the amendments would supplement the list of matters which the Takeovers Panel may take into account when considering whether a target has in fact engaged in unacceptable frustrating action. The new items on this list would be:

- whether a condition has been triggered and the bidder has not disclosed whether it will rely on it or waive it within a reasonable time, and
- whether a condition has been triggered, and the bidder has varied the terms of the bid, such as increasing the bid price, but has not waived the condition (or waived the particular breach of the condition).

Given that, under the existing policy, unacceptable frustrating action is unlikely to arise if target shareholders have already 'rejected' a bid, the Takeovers Panel also proposes to include some additional comments to the effect that it may be unacceptable for the bidder to 'hold open' a triggered condition of this type and prevent a conclusion about whether there has been such a rejection.

While each situation will still need to be considered on its merits, it is likely that amendments of this type – if adopted – should provide a means of obtaining additional clarity for target boards and shareholders when considering the prospects of a bid and the options open to the target.

SUMMARIES IN TAKEOVERS DOCUMENTS

The Takeovers Panel has proposed amendments to its Guidance Note on takeover documents (GN 18) to 'encourage' the inclusion, upfront in takeover documents, of a summary of the offer that is 'accessible to retail shareholders'.

The Takeovers Panel also sets out what it considers is its best practice guidance on the form of the summary. The form of the summary proposed by the Takeovers Panel is relatively prescriptive, including as to:

- the location of the summary – the Takeovers Panel says it should normally follow the Chairman's letter,
- font size – the Takeovers Panel says the font of the summary should be no less than 10 point,
- headings and content – the Takeovers Panel sets out, in considerable detail, the headings and content that it expects to see, and
- length – the Takeovers Panel says it should be short enough to be comprehended quickly and the Takeovers Panel is seeking views on whether the Guidance Note should specify a page limit.

Whilst these changes are not, of themselves, objectionable, they are quite prescriptive and one might query whether it would not be better for the Takeovers Panel to simply state that every bidder's statement and target's statement should contain a short summary upfront.

DIVIDENDS AND TREATMENT OF FRANKING CREDITS

The Takeovers Panel's decisions in the *Alesco and Warrnambool Cheese and Butter* matters highlighted the inherent difficulties in attempting to place a value on franking credits in the context of bid consideration, noting that franking credits will be valuable to some shareholders (eg Australian retail shareholders) and are unlikely to have any value to other shareholders (eg foreign shareholders).

This has given rise to two issues that the Takeovers Panel is seeking to address in a new Consultation Paper relating to a proposed new Guidance Note on dividends.

Attributing a value to franking credits in an announcement

First, the Takeovers Panel is saying that the inclusion in an announcement of the value of franking credits in a 'headline' offer price is likely to give rise to unacceptable circumstances. The Takeovers Panel says any reference to the value of franking credits should be made in a 'separate, suitably qualified statement'.

The Takeovers Panel gives the following example of an inappropriate announcement:

'Bidder today announced that it is increasing its offer for target by increasing the cash offer from $1.50 to $1.90 per share (and further potential increase up to $2.07 per share) by allowing shareholders to receive the 40c fully franked dividend and to receive up to a further 17 cents per share in franking credits attached to the dividends declared.'

The Takeovers Panel provides the following example of a 'separate, suitably qualified statement' in relation to the value of franking credits:

'Attached to the $0.40 fully franked dividend will be a franking credit of $0.17. Certain shareholders will be able to use this as an offset to their liability for Australian tax, although the franking credit itself needs to be included in taxable income and is therefore subject to tax'.

This effectively restates existing policy.

Deducting the value of franking credits from the bid consideration

Secondly, the Takeovers Panel is seeking to address the question of what value a bidder attributes to franking credits if it intends to reduce the bid consideration by the amount of any franking credits retained by target shareholders.

By way of background, the market practice is for a bidder to include in its offer terms a clause stating that, if the target declares a dividend and that dividend is received by target shareholders (rather than by the bidder), the bidder will reduce its bid consideration by the value of that dividend. This much is uncontroversial – bidders often reduce their bid consideration in such circumstances.

In addition, it is not uncommon for bidders to include a clause in their offer terms stating that the bidder is entitled to also reduce its bid consideration by the value of the franking credits attached to the dividend.

The Takeovers Panel is proposing that, if the bidder wishes to retain the right to reduce the bid consideration by the amount of the franking credits, the bidder must clearly state in its bidder's statement how the deduction for franking credits will occur, either by a formula or as a fixed amount.

If the new policy is adopted, it will no longer be acceptable for the bidder to state – as many bidders currently do – that it will be entitled to deduct an amount equal to the value of the franking credits 'as reasonably assessed by it'.

In this regard, the Takeovers Panel has suggested, as an example of an acceptable valuation formulation, the following wording:

'Bidder will value franking credits at 50% of their face value'.

Again, there is nothing objectionable in this proposed policy.

ENDNOTES

1. Simon Haddy, 'Frustrating binds must be torn from the targets of takeovers', The Australian, 25 July 2013.

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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