

PRE-EMPTION RIGHTS: BUYERS (AND SELLERS) BEWARE

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Legal Briefings - By **Matthew Fitzgerald** and **Mary Boittier**

OVERVIEW

In the current challenging environment for our mining industry, there is significant rationalisation and a large number of assets on the market. Since a large number of mining projects in Australia involve joint venture arrangements, it is important that any parties to an M&A transaction involving a joint venture consider, and pro-actively deal with, pre-emption rights.

Pre-emption rights in joint ventures are usually bespoke, having been carefully negotiated by the parties when establishing the joint venture. Sellers and buyers need to thoroughly examine the scope and operation of any pre-emption rights in the context of their sale transaction. Those who fail to have due regard to all pre-emption provision requirements do so at their peril.

PRE-EMPTION RIGHTS HAVE A RECOGNISED (AND LEGITIMATE) ROLE

As courts have recognised, pre-emption rights have a valid role in resource joint venture agreements. Pre-emption rights allow an existing joint venture participant to:

- exclude potential new participants whose identity, financial capacity or reliability may be of concern; and
- increase its interest and potentially reap the rewards from past risk-taking and expenditures.

While pre-emption rights are generally narrowly construed, Australian courts have recognised that caution needs to be exercised before adopting a construction which would restrict the operation of a pre-emption right or permit their operation to be avoided.

Pre-emption rights can be difficult to administer and create legal complexities.

There are any number of variations on a pre-emption rights provision and the following characteristics of some typical provisions can be of particular concern for both seller and buyer parties.

1. Timing and (troublesome) interaction with a sale process

The timing requirements for pre-emption rights are rarely structured around assisting an orderly and timely competitive auction process by a seller. Rather, the timing requirements are often negotiated with the joint venture participants taking careful account of their own circumstances.

The timing requirements prescribed by a pre-emption provision can make it difficult for the potential buyer and seller to achieve deal certainty, particularly in a competitive auction process. By way of example:

- A seller may be required to offer the joint venture interest to the remaining participants after a prospective buyer's offer has been fully negotiated or accepted (subject to receipt of a pre-emption waiver).
- The period allowed for the remaining participants to respond to the offer to acquire the sale asset may be significant. Where not all participants accept the offer for their proportionate interest in the sale asset, some pre-emption provisions require a further round of offers to be made to the accepting participants which are open for acceptance for the same time period.

These types of issues create significant headaches for prospective sellers and buyers which are difficult to manage. For example, how will prospective buyers feel about incurring significant time and costs on the purchase of a joint venture interest in a competitive sale process without some comfort that the other participants will not exercise their pre-emption rights?

2. Offer terms

Typically, the offer made to the remaining participants is required to mirror the offer made by the potential buyer to the seller. It may be difficult to strictly comply with this requirement or hard to identify the precise terms of the buyer's offer that must be extended to the remaining participants.

For example, if the terms of sale with the potential buyer include, in addition to the purchase price, the entry into a long term offtake agreement, does this aspect of the offer need to be extended to the remaining participants. If so, is this a workable arrangement?

It may also be challenging to draft a compliant offer where the pre-emption rights require that the offer be for a cash price in circumstances where the buyer's offer is for, or includes, non-cash consideration.

3. Making a non-compliant offer

A seller who tables an offer to the remaining participants that does not strictly comply with:

- the requirements of the pre-emption rights provision; or
- the timing and other technical requirements of the provision,

is taking a serious risk that the offer will be challenged as invalid (which may result in the offer having to be re-structured and the pre-emption process re-started). This is not a risk that a seller should be taking unless it has some comfort as to how the remaining participants will respond. This risk can be mitigated by an early engagement with the remaining participants and seeking their approval, whether formal or informal, to the structure of the 'non-compliant' offer or even better, seeking a pre-emption waiver.

4. To waive or not to waive?

The best way to address complexities associated with pre-emption rights is to obtain an upfront waiver from existing joint venture participants (usually in the form of a deed or deed poll). While this is an ideal solution, it is often difficult to obtain an upfront waiver. This is for a variety of reasons including that joint venture participants may not wish to waive rights without a complete picture of the new landscape or to give up a right without obtaining something in return. In these circumstances, joint venture participants commonly wait out the offer period and make a decision at the end of the offer period.

In the current market, a low (or even negative) cash price for a joint venture interest in a pre-emption offer notice may be attractive to certain remaining participants. However, most joint venture participants seem to be very cautious in the current environment about expanding their exposure to challenged mining projects.

In our experience, remaining participants in a joint venture are more likely to waive their pre-emption rights where the identity of the buyer is known and the remaining participants are satisfied of that party's reputation, financial and technical capability. Indeed, certain pre-emption provisions have detailed requirements that a prospective buyer must satisfy prior to being considered as a joint venture participant.

These factors mean that obtaining a waiver of pre-emption rights in a competitive auction process may be more difficult as the identity of the buyer may not be known at the stage the waiver is sought.

BUYERS (AND SELLERS) BEWARE

Buyers and sellers must carefully consider the precise terms of pre-emption provisions and assess any potential difficulties in making a compliant pre-emption offer due to their proposed sale terms or sale structure.

In the absence of obtaining an upfront pre-emption waiver, any failure to strictly comply with pre-emption provisions may render a pre-emption offer invalid. This can necessitate the making of a compliant pre-emption offer or prevent the sale transaction proceeding if the relevant parties are unwilling or unable to provide a compliant offer.

This article was written by Matthew FitzGerald, Partner and Mary Boittier, Executive Counsel, Brisbane.

MORE INFORMATION

For information regarding possible implications for your business, contact Matthew FitzGerald or Mary Boittier.

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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