

REVISION OF TAKEOVERS PANEL GUIDANCE NOTE 17: IS IT MAINLY MORE OF THE SAME?

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Legal Briefings - By **Tim McEwen**

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IN BRIEF

The Takeovers Panel (**Panel**) considers more rights issues than you may expect – 17% of its decisions in 2017 and 26% of its decisions in 2016 relate to rights issues. The Panel is currently seeking submissions on proposed amendments to clarify its commentary on rights issues in Guidance Note 17 (**GN17**).

GN17 has had a substantial impact on the structuring of rights issues even where the issue has not been subject to a Panel proceeding.

- The proposed revisions are largely a refinement of existing provisions.
- Should a ‘clear need for funds’ and an appropriate dispersion strategy mean that a rights issue will generally not be unacceptable?
- Will proposed new commentary that ‘unacceptable circumstances may arise if an underwriter is interested in control, rather than merely laying off the risk of holding shares’ encourage too much focus on, and speculation about, the possibility of control and the underwriter’s intentions as opposed to the structure of the rights issue?

MITIGATING POTENTIAL CONTROL EFFECTS

Rights issues are a specific exception to the 20% rule in section 606 of the Corporations Act. GN17¹ provides that where there is the potential for a rights issue to affect control, the directors should carefully consider all reasonably available options to mitigate that effect.

The Panel's proposed amendments are not a substantial revision of its approach contained in the current GN17. The amendments are largely a proposed refinement and slight expansion of detail of some of the existing provisions.

The proposed revisions bring forward in GN17 and expand on what actions and structures may mitigate the potential control effects of a rights issue. These include:

- making a rights issue renounceable where an active market for the rights is likely - while renounceability itself is not a safe harbour, this is a clearer statement of the Panel's position on renounceability;
- offering a shortfall facility:
 - for securityholders (or others) to take up securities in advance of shortfall being available to the underwriter;
 - where if shortfall applications exceed the available shortfall, the shortfall is allocated on a pro rata basis and any cap on securityholders participation should not materially restrict the ability of securityholders to participate;
 - directors should not otherwise exercise discretion regarding the shortfall in a manner likely to exacerbate a potential unacceptable control effect except to prevent contravention of the Corporations Act or the Listing Rules;
- using a similarly effective shortfall dispersion strategy; and/or
- informed approval by non-associated securityholders of the rights issue and underwriting/sub-underwriting.

Additional features of an appropriate dispersion strategy include using several non-associated sub-underwriters, the underwriter and sub-underwriters only receiving securities after all other applications have been satisfied, sufficient time being given to securityholders and other investors to assess the offer and external investors being able to take up securities under the dispersion strategy.

The proposed amendments include the following new paragraph upon which the Panel is seeking submissions as to whether (if there is a clear need for funds and an appropriate dispersion strategy has been put in place) structural issues, such as the pricing and size of the rights issue, are still relevant in determining whether the rights issue is unacceptable:

'Where there is a clear need for funds which has not been caused or induced by a person who may benefit from any potential control effect or their associates, a rights issue will generally not be unacceptable provided an appropriate dispersion strategy has been put in place.'

The paragraph is footnoted to make clear that structural matters, in particular pricing and the size of the rights issue may still be relevant.

Overall a clear need for funds will not be a complete safe harbour and there is no safe harbour at all without a dispersion strategy, but we expect that this new paragraph is intended to make it clearer that the need for funds will be given greater weight by the Panel as a counterbalance to other factors.

The existing provisions dealing with unacceptability factors are proposed to be retained without substantial amendment.

The Panel has clarified that it always expects appropriate disclosure to securityholders in relation to the rights issue, irrespective of what form of disclosure is used by the issuer, ranging from a 'full' prospectus through to a 'cleansing notice'.

UNDERWRITING

The Panel has retained its existing paragraphs dealing with underwriting including that an underwriter may be a professional underwriter, related party, unrelated party or a major securityholder. The Guidance Note has always noted that a professional underwriter is unlikely to have an interest in obtaining control of the issuer. The Panel now proposes to include the following footnote to that paragraph:

'Unacceptable circumstances may arise if an underwriter is interested in control, rather than merely laying off the risk of holding shares.'

The Panel's consultation paper specifically asks whether readers agree with the proposed footnote.

Two questions which the proposed footnote raises are:

- whether it will encourage too much focus on, or speculation about, the possibility of control and the underwriter's intentions as opposed to the structure of the rights issue; and
- does it reflect an assumption that an underwriter or sub-underwriter should be a professional underwriter, albeit that the Panel recognises that for many issuers a related party or major shareholder is the only realistic source of underwriting or sub-underwriting.² Further as the Panel notes, and inherent in the exceptions to section 606 for rights issues, the fact that control is affected by a rights issue does not of itself give rise to unacceptable circumstances.³

RESPONSE TO THE PANEL

Herbert Smith Freehills will be preparing a response to the consultation paper which is due on Friday 6 April 2018.

We would be pleased to speak to anyone who has views on the consultation paper. Please contact the author or any other partner in the Mergers & Acquisitions group.

ENDNOTES

1. Paragraph 5 of GN17.
2. Current paragraph 21 of GN17 which is proposed to be renumbered paragraph 25.
3. Paragraph 4 of GN17.

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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