STUB EQUITY: ASIC CONFIRMS BAN ON PROPRIETARY COMPANY CUSTODIAN STRUCTURES BUT PUBLIC COMPANY STUB DEALS CAN PROCEED

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Legal Briefings – By **Rebecca Maslen-Stannage and Mia Harrison-Kelf**

ASIC has confirmed its ban on the use of Australian proprietary companies in stub equity deals, but has accepted the use of Australian public companies subject to anti-avoidance measures.

IN BRIEF
• ASIC has finalised its position on stub equity offers in takeovers and schemes following consultation.
• The new rules confirm the ban on use of Australian proprietary company custodian structures as stub equity vehicles.
• Australian public companies with compulsory custodian arrangements will be permitted, but new anti-avoidance provisions impose restrictions on their conversion to proprietary companies once the deal is completed.
• Bidders therefore have a choice of an Australian public company or an offshore stub equity vehicle.
• We welcome ASIC's acceptance, having considered the consultation submissions, that Australian public company custodian structures can be used. Target shareholders will generally prefer an Australian stub equity vehicle to a more complex foreign equity structure.

BACKGROUND

Stub equity deals, in which target shareholders are offered scrip in a special purpose vehicle which owns the target company post-implementation, have been in use for a number of years in the Australian market, particularly in private equity deals. The bidder offers target shareholders a choice of cash or stub equity, enabling the bid to appeal to both shareholders who wish to exit for cash and those who want continued exposure to the business and prefer to ride the private equity train to a future exit. Stub equity deals can also provide additional funding flexibility for the bidder – for example by making the offer conditional on a particular level of stub equity elections.

The bidder needs to comply with the takeovers rules to implement the bid – but the bidder will see as critical having flexibility to run the business in a way it considers adds value and to exit at time and manner of its choosing. This means it is important from the bidder's perspective that takeovers restrictions do not apply again at the exit stage, as they could if the stub equity vehicle was an Australian company with more than 50 members.

Historically, foreign vehicles from jurisdictions with bidder-flexible takeovers rules were often used for stub equity vehicles. In recent years, it has become more common for Australian companies to be used as stub equity vehicles, with a custodian structure in place. This custodian structure requires the stub equity shares to be held by a specified trustee for the target shareholders if there would otherwise be more than 50 shareholders in the company.

In the Capilano Honey Limited scheme of arrangement in 2018,[1] an Australian proprietary company custodian structure was used for this purpose – and target shareholders had the option of not only electing to receive stub equity for their Capilano shares but also a right to subscribe for further stub equity shares in the form of cash. This looked novel because conventional wisdom is that Australian proprietary companies are very limited in their ability to raise capital. But in fact the law permitted an Australian proprietary company to be used in this way with a custodian structure in conjunction with a scheme of arrangement, and no prospectus was required for the capital raising component.

ASIC raised concerns regarding the use of this proprietary company stub equity structure. The Court acknowledged ASIC's concerns but ultimately approved the Capilano deal. However, following that deal, ASIC placed an interim ban on use of that Australian proprietary company structure. ASIC also raised the prospect that it would also ban use of an Australian public company with a custodian arrangement on the basis investors would not have the benefit of various protections under the Corporations Act, including the takeovers rules or the disclosing entity provisions. ASIC's broader proposal to restrict use of Australian public company custodian structures surprised the market. Bidders moved back to using foreign stub equity vehicles while the consultation process was underway.[2]

PROPRIETARY COMPANIES ARE OUT FOR STUB EQUITY DEALS…

ASIC has now released *ASIC Corporations (Stub Equity in Control Transactions) Instrument 2020/734* (**Stub Equity Instrument**), confirming new restrictions and guidance on which Australian companies can be used for stub equity offers in takeovers and schemes.

ASIC has confirmed its ban on the use of Australian proprietary companies as stub equity vehicles by exercising its power to modify the Corporations Act.

...BUT PUBLIC COMPANIES WITH COMPULSORY CUSTODIAN ARRANGEMENTS ARE PERMITTED

ASIC had regard to the weight of consultation submissions emphasising the benefits to bidders and target shareholders of the use of an Australian company as the stub equity vehicle, and decided not to pursue the broader ban on Australian public company custodian arrangements ASIC had floated in consultation. However, in order to ensure these public companies do not simply convert to proprietary companies once the deal is completed, ASIC has imposed anti-avoidance provisions under the Stub Equity Instrument.

Where stub equity in a public company with compulsory custodian arrangements is offered under a takeover or scheme, ASIC now requires that the custodian arrangement must provide that the arrangement will terminate and the beneficial owners will be registered as the holders of the securities if the company wishes to change to a proprietary company when it has more than 50 non-employee beneficial owners. Although this restriction is entrenched in the custodial arrangement itself (rather than an ongoing obligation imposed under the Corporations Act), it can only be amended by special resolution (i.e. 75% vote) of the beneficial holders whose securities are held by the custodian. This would not prevent conversion to proprietary company status if there would be less than 50 members because fewer than that level of target shareholders elected to receive stub equity rather than cash.

WHAT DOES THIS MEAN FOR BIDDERS AND TARGET SHAREHOLDERS?

It is welcome that ASIC took on board the feedback received in consultation regarding the benefits of this structure for both bidders and target shareholders and will permit the use of Australian public company custodian structures going forward subject to anti-avoidance safeguards. Bidders retain the flexibility to use custodian arrangements to simplify offer and disclosure obligations if an Australian public company is selected over a foreign offshore entity without jeopardising their exit flexibility. The means that target shareholders will be more likely to be offered interests in the Australian public company stub equity custodian vehicle they would typically prefer over foreign vehicles.

ENDNOTES

1. The authors acted for Capilano on this deal.

2. For example, the 2019 Aveo acquisition by Brookfield on which the authors acted for Aveo, in which a Bermudan stub vehicle was used.

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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