HERBERT SMITH FREEHILLS

THE END OF BROKER HANDLING FEES IN TAKEOVER BIDS?

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Legal Briefings – By **Rodd Levy** and **Kam Jamshidi**

SUMMARY

- Broker handling fees paid to stockbrokers by bidders to solicit acceptances are potentially prohibited as 'conflicted remuneration'.
- This is despite the Takeovers Panel's long-standing acceptance that, with appropriate safeguards, broker handling fees can promote an efficient, competitive and informed market.
- The development will see the loss of a useful tool in soliciting acceptances, which has been used by bidders for many years.

A view is emerging that bidders may lose a useful tool in the battle to mobilise shareholders to accept takeover bids, with the Future of Financial Advice reforms potentially capturing broker handling fees as prohibited 'conflicted remuneration'.

This has the potential to alter long-standing market practice, which has been supported by the Takeovers Panel, where bidders may offer such fees if not excessive or used to solicit premature acceptances well ahead of the offer end date.

THE EVOLUTION OF THE PANEL'S POSITION ON BROKER HANDLING FEES

Broker handling fees have historically been offered by bidders to stockbrokers to solicit acceptances from their clients during takeover bids. These arrangements, where reasonable, have been considered a useful tool to facilitate the acquisition of shares in an efficient, competitive and informed market by incentivising brokers to provide information to shareholders. The fees are often particularly useful where the target's register has a lot of small retail shareholders whose apathy may otherwise prevent a bidder from reaching minimum acceptance conditions or the thresholds for compulsory acquisition.

Although used for many years previously without complaint, AngloGold's bid for Normandy Mining in 2001 brought the use of broker handling fees under scrutiny. AngloGold offered handling fees of up to 2.5% of the value of the consideration to brokers targeted over a one week period well before the offer was due to close. The Takeovers Panel found that both the size and the early expiry date for availability of the fee had the potential to induce brokers to pressure their clients to accept the AngloGold bid prematurely and it therefore gave rise to unacceptable circumstances.

The Panel's decision led to the adoption of the Takeovers Panel's Guidance Note 13 on broker handling fees, which settled much of the practice surrounding them. Guidance Note 13 curtailed the use of such fees where excessive or used to apply unacceptable time pressure. The Panel's guidance note effectively capped the fee that bidders could pay per acceptance to the lesser of 0.75% of the consideration on offer or $750, with a minimum fee of $50 not considered to be unacceptable.

FUTURE OF FINANCIAL ADVICE REFORM

The Future of Financial Advice reforms introduced by the Federal Government were born out of the findings of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into financial products and services in Australia and the role of financial advisers.

The Committee recommended that remuneration structures incompatible with a financial adviser's proposed fiduciary duty be removed. In response, section 963E of the Corporations Act was enacted, prohibiting the payment or acceptance of 'conflicted remuneration'.

'Conflicted remuneration' is defined under the Corporations Act to catch any benefit given to a financial services licensee who provides financial product advice to retail clients that, because of the nature of the benefit or the circumstances in which it is given, could reasonably be expected to influence the advice given.

ASIC's Regulatory Guide 246 Conflicted Remuneration sets out the factors that ASIC will consider in deciding whether a benefit is conflicted remuneration including (among other reasons) who is giving the benefit, when the benefit is given and what the likely reason for the benefit is.

On one view, broker handling fees paid in conjunction with advice to target shareholders may fit within that definition. There is a contrary view that may be open that, where the broker would have advised his or her clients to accept even if no fee was payable, the handling fee cannot be said to have influenced the advice given. However, it is not clear if that view would be acceptable to ASIC.

Given the broad scope of the prohibition on conflicted remuneration, there are various exceptions under the Corporations Act, but none directly expressly apply to broker handling fees. For example, the exception for the sale of financial products without the provision of financial advice (also known as the "execution" exception) is unlikely to apply to broker handling fees given that, by their nature, such fees are likely to involve the provision of advice to accept the bid. The exception for benefits given or authorized by the client could potentially apply, but the client would need to give specific consent. It would not be enough that the client merely knew of the arrangement and allowed the payment to be made after disclosure.

COMMENTARY – RAMIFICATIONS

Broker handling fees have come and gone in fashion. However, there are plenty of examples of bids retaining the flexibility to use handling fees in bids. In CIMIC Group's current bid for Sedgman and Ferrovial's current bid for Broadspectrum, both bidders reserve the right to introduce handling fees for broker solicitation. In last year's Crescent Capital Partners' successful bid for Cardno, a handling fee of 0.50% of the consideration up to a $500 cap per acceptance was thought useful enough to be introduced a month after the initial bidder's statement.

In our experience, broker handling fees are a useful part of Australian takeovers practice and, as accepted by the Takeovers Panel, can promote an efficient, competitive and informed market. The safeguards introduced by the Panel in Guidance Note 13 are, in our view, an appropriate way of dealing with the potential conflicts that the arrangements could create.

We consider that a strong case for introducing a further express exception to the conflicted remuneration prohibition can be made out for broker handling fees. Because ASIC does not have a class order power for the conflicted remuneration provisions, this would need to be achieved by regulation (which is how the IPO-related brokerage fee exemption is granted). A less preferable, but still helpful, outcome would be for ASIC to amend its policy to include a no-action position for such fees.

However, as things stand at present, bidders should think carefully before offering such fees as part of their arrangements to solicit support for their takeover bid.

Could the prohibition extend to similar fees for proxy solicitation by brokers in the context of a scheme of arrangement? It is not clear if proxy solicitation for schemes would constitute 'financial product advice' by brokers, as the advice being given is in relation to *rights attaching* to a financial product rather than advice *in relation to* a financial product. The argument that a handling fee is not caught would be stronger where the proposal the subject of the vote does not involve a disposal of the shares, such as a vote to appoint or remove directors or to approve a structural change to the company.

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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