Australian Government

Takeovers Panel

Consultation Paper

GN on Dividends

10 January 2014

Introduction

1. The Panel invites comments on the draft Guidance Note on Dividends attached. The time for comments is open until **Friday, 28 February 2014.**
2. Comments or queries can be directed to:

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3. It is Panel policy that submissions are public.
4. The Panel will consider all comments and reserves the right to make changes to the draft Guidance Note in response to comments or otherwise.

Background

5. The issue of the treatment of franking credits arose before the Panel in the *Alesco*[1] and *Warrnambool*[2] matters.
6. In *Alesco*, the issue was the inclusion of a reference to the value of franking credits in the 'headline' offer price. In *Warrnambool*, the issue was that a dividend proposal that endeavoured to give the value of franking credits to target shareholders was conditional, complex and essentially unworkable.

Issues

Franking credits in the 'headline' offer price

7. The Guidance Note makes it clear that including the value of franking credits in the 'headline' offer price is likely to give rise to unacceptable circumstances.
8. The Guidance Note also expands on the comments in *Alesco 01 and 02*, where the Panel stated:

   … the appropriate way to make an announcement of bid consideration that comprises a cash component and a cash dividend component is usually to add those two elements together, with due regard to the effect of the dividend record date on offerees who have traded during the bid. To the extent any reference is made to potential franking credit

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[1] *Alesco Corporation Limited 01 and 02* [2012] ATP 14 and *Alesco Corporation Limited 03* [2012] ATP 18

[2] *Warrnambool Cheese and Butter Factory Company Holdings Limited* [2013] ATP 16

value, it should be the subject of a separate statement, as (for example) was done in the PEP/ Spotless case.[3]

Reservation of the right to deduct the value of franking credits

9. Takeover bids commonly reserve the bidder's right to deduct from the offer consideration the value of any dividends (and the associated franking credits) when franked dividends are paid during a bid. Such a reservation, and the possible exercise of it, may create uncertainty and potentially disadvantage some shareholders.
10. The Guidance Note makes it clear that a deduction assessed by reference to the franking of a dividend is likely to give rise to unacceptable circumstances, unless the bidder's statement made it clear how that deduction would be calculated (either by a formula or as a fixed amount) and the basis for adopting that calculation.

Truth in takeovers

11. Truth in takeovers policy can apply to statements about franking credits. The Guidance Note warns market participants of the need to address franking credits if relevant to a 'last and final' statement.

Comments sought

12. Comments are sought generally, in particular on whether the Guidance Note should be adopted as policy and whether there are any practical issues the Panel should address.

Attachment

1. Draft GN Dividends

[3] *Alesco Corporation Limited 01 and 02* [2012] ATP 14 at [40]

Attachment 1

Guidance Note [ ] – Dividends

Introduction

1. This guidance note has been prepared to assist market participants understand the Panel's approach to the treatment of franking credits when dividends are paid during a bid.
2. The examples are illustrative only and nothing in the note binds the Panel in a particular case.
3. For ease of reading this note assumes a fully franked cash dividend is paid, but similar principles will apply with other franked dividends.
4. The policy bases for this note are that:
   - the acquisition of control over voting shares should take place in an efficient, competitive and informed market[4]
   - bids should not be the subject of uncertainty and
   - under s619(1) all offers under an off-market bid must be the same regardless of the tax position of the offeree.

Franking credits in the 'headline' offer price

5. It is likely to give rise to unacceptable circumstances for a bidder to include the value of franking credits in its headline offer price.

   Example: 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

[4] Section 602(a). References are to the *Corporations Act 2001* (Cth) unless otherwise indicated

*dividend and to receive up to a further 17 cents per share in franking credits attached to the dividends declared (**Revised Offer**).*

6. The appropriate way to describe an offer comprising a cash sum from the bidder and a cash dividend from the target is to add those two elements together. Any reference to the value of franking credits should be made in a separate, suitably qualified statement.

7. Such a statement might say, for example, "*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*". The Panel in *Alesco Corporation Limited 01 and 02*[5] identified an example, although the statement in that matter did not capture tax consequences for more than one group of shareholders.

Deduction for franking credits

8. Takeover bids commonly contain a term reserving the bidder's right to deduct the value of any 'Rights' attaching to the target shares that the bidder does not receive.[6] The term 'Rights' is typically defined as dividends and other distributions by the target to its shareholders. The purpose of this term is to protect the bidder against the risk that the value of the target is diminished due to a distribution made by the target to its shareholders during the offer period.

9. Some bids include franking credits in the definition. Some bids refer separately to franking credits. The following is an example of a generally expressed term.

   Example: If you accept this Offer, Bidder is entitled to all Rights in respect of your Shares. Bidder may require you to provide all documents necessary to vest title to those Rights in Bidder, or otherwise to give it the benefit or value of those Rights. If you do not give those documents to Bidder, or if you have received the benefit of those Rights, Bidder will deduct from the consideration otherwise due to you the amount (or value as reasonably assessed by Bidder) of those Rights, together with the value (as reasonably assessed by Bidder) of the franking credits, if any, attached to the Rights.

[5] [2012] ATP 14 at [40], where the Panel referred with approval to the ASX announcement made in the PEP/Spotless transaction. That announcement specified a headline consideration comprising the cash and dividend and added separately "*Those shareholders who can capture the full benefit of the franking credits associated with the Special Dividend will receive an additional benefit valued at $0.016…*"

[6] This term may be in addition to a bid condition that no dividends are paid by the target

10. Such a term would entitle the bidder to make an adjustment for the amount of a dividend. With an adjustment for the payment of a cash dividend each shareholder who accepts the bid receives the same amount for each share but from two sources (ie, some from the bidder and some from the target).

11. Such a term would also entitle the bidder to make an adjustment for the value of any franking credit attaching to the dividend.[7] However:

    (a) as all the offers under an off-market bid must be the same, a bidder cannot make individual adjustments for the value of franking credits depending on the tax circumstances of each offeree, even if that was practicable and

    (b) it is likely to give rise to unacceptable circumstances for a bidder to seek to deduct an amount that is not clearly defined (for example, 'as reasonably assessed' by it), because such an assessment creates uncertainty and detracts from an informed market.[8] Therefore, the example in paragraph 9, although perhaps effective as a contractual term, would be likely to give rise to unacceptable circumstances.

12. Accordingly, a bidder should make it clear in the bidder's statement how any deduction for franking credits is established, either by a formula or as a fixed amount. The basis for adopting that calculation should be reasonable and should be set out clearly in the bidder's statement in a way that shareholders can understand.

    Example: Bidder offers 40 cents for each share in Target. During the offer period, a fully franked dividend of 14 cents per share is paid by Target. Bidder can lower the amount of cash it pays shareholders to 23 cents, if the bidder's statement:
    (a) has provided that, for the purposes of the term allowing the deduction of the value of 'Rights', Bidder will value franking credits at 50% of their face value and
    (b) has established the basis for that figure.

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[7] Under section 650B(1)(g), giving shareholders a right to retain a dividend improves the bid consideration: *Rinker Group Limited 02R* [2007] ATP 19 at [56]. Therefore, as part of the terms of its offer a bidder must have reserved the right to deduct from the consideration payable the value of any franking credits attached to a dividend

[8] Another type of uncertainty arose in *Warrnambool Cheese and Butter Factory Company Holdings Limited* [2013] ATP 16. In that case, to distribute the value of franking credits to shareholders, the target (by agreement with the bidder) announced an intention to declare special dividends involving the establishment of a 'conditional' (and effectively retrospective) record date without there being any certainty of the dividends being paid. The Panel referred to the arrangements as complex, creating uncertainty and undesirable, and said that it did not want to see similar arrangements in future: see para [54]

Note: the deduction is 17 cents in this example, namely 14 cents for the cash dividend plus 3 cents for the 6 cent franking credit (that is, 50% of the face value).[9]

13. It would also follow that a bidder making a 'last and final' statement should clearly address what will happen if the target pays a dividend to which franking credits are attached. If not, allowing shareholders to retain the benefit of franking credits may constitute a departure from the 'last and final' statement.

Publication History

First Issue [ ] 2014

[9] Valuing the franking credit at 50%of its face value will not necessarily be appropriate in every case