

Article Information

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ASIC formalises approach to use of stub equity vehicles in takeovers

ASIC has placed limitations upon stub equity transactions, imposing conditions on the use of mandatory custodial arrangements and restricting the use of proprietary companies as stub equity vehicles.

On 22 September 2020, the Australian Securities and Investments Commission (**ASIC**) issued *ASIC Corporations (Stub Equity in Control Transactions) Instrument 2020/734* (**Instrument 2020/734**) regulating the use of stub equity in takeover bids and schemes of arrangement.

Proprietary companies as stub equity vehicles

ASIC Instrument 2020/734 modifies Chapter 6D such that the disclosure exemptions for takeovers and schemes of arrangement in s708(17) and (18) of the Corporations Act are not available for an offer of securities in a proprietary company. This effectively prohibits the use of a proprietary company as a stub equity vehicle unless another disclosure exemption is available.

The modification is consistent with the approach in Consultation Paper 312 *Stub equity in control transactions* (**Consultation Paper 312**), issued by ASIC in July 2019. In CP 312, ASIC noted the importance of investors in widely held companies being afforded the safeguards that the law explicitly contemplates for shareholders of public companies, including:

- restrictions on related party transactions under Ch 2E;
- restrictions on conflicted directors voting under s195;
- rules for the appointment and removal of directors under s201E and 249H(3);
- Australian residency requirements for directors under s201A(2);
- a requirement to hold annual general meetings under s250N; and
- periodic financial reporting obligations under Ch 2M (noting, however that large proprietary companies are also subject to these requirements).

While Instrument 2020/734 generally prohibits the use of proprietary companies as stub equity vehicles, ASIC has stated in its response to the submissions on its June 2019 Consultation Paper that it will consider and may provide individual relief to permit offers of proprietary company securities on a case-by-case basis if it is in the interests of target security holders to do so.

Mandatory custody arrangements

ASIC Instrument 2020/734 also modifies the regulatory settings for mandatory custodial arrangements in stub equity transactions.

The Instrument modifies Chapter 6 of the *Corporations Act 2001* (Cth) (**Corporations Act**) such that the takeover exemptions in items 1-4 (takeover bids) and 17 (schemes of arrangement) of section 611 of the Corporations Act will only be available for mandatory custodial arrangements in stub equity transactions where the custodial arrangement contains prescribed 'conversion and termination provisions'. The prescribed conversion and termination provisions are triggered where a stub equity vehicle converts into a proprietary company, with the following consequences:

- the custodial arrangement terminating once the change takes effect; and
- the beneficial owners of the shares will be registered as holders of the securities.

The provisions are designed to prevent stub equity vehicles later converting to proprietary companies using mandatory custodial arrangements which reduce the number of shareholders in a stub equity vehicle under 50.

This modification is a shift in ASIC's initial approach as set out in Consultation Paper 312, which proposed a restriction in the availability of takeover exemptions in items 1-4 (takeover bids) and 17 (schemes of arrangement) of section 611 of the Corporations Act in circumstances where mandatory custodial arrangements were being used. In its response to the submissions on its June 2019 Consultation Paper, ASIC noted that the ban in the use of custodial arrangements may lead to bidders resorting to the use of foreign incorporated stub equity vehicles, resulting in retail investors losing all the protections afforded under Australian law. Instead, ASIC has introduced a balanced modification, which aims to address the interests of bidders and retail investors.

ASIC's media release concerning the modifications, Instrument 2020/734 and Consultation Paper 312 is available to be viewed [here](#).