Collateral benefit? Solomon Lew's pot of Country Road gold

June 25, 2014 11.18am AEST

Collateral benefit, or just good business sense? Julian Smith/AAP

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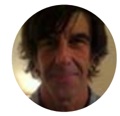

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Retailer David Jones has found itself in the middle of ongoing market intrigue since last year, spurred on by a merger approach from Myer. The advance was rejected without shareholders being made aware.

Into this mix came revelations directors had acquired DJs shares with knowledge of Myer's approach. ASIC investigated the directors' share trades but took no action.

Then, seemingly out of the blue, South African retailer Woolworths made an offer for DJs with an attractive premium and which has been strongly supported by the DJs board. The next ingredient into this mix was Solomon Lew, the 9.89% stakeholder in DJs who shaped up as an obstacle to Woolworths' plans.

This is where it stood until the news broke that Woolworths had offered to acquire Lew's stake in Country Road, at a significant premium. The South African retailer currently has 88% of Country Road and is seeking total control, provided it gets the acceptance from Lew, together with the remaining other few shareholders. Lew is understood to have threatened to block the David Jones acquisition unless Woolworths acquired his stake in Country Road.

What is collateral benefit?

Once again, ASIC may return to the DJs mix - providing the Woolworths takeover of DJs goes ahead, and the acquisition of Lew's shares in Country Road (if the proposal goes ahead) amounts to a "collateral benefit" under section 623 of the Corporations Act.

Under the Act a bidder must not during the offer period for a takeover agree to give a benefit to a person to induce the acceptance of an offer, unless that benefit is offered to all shareholders.

The Act defines a benefit widely as a payment of "cash or otherwise" and the courts and the Takeovers Panel confirm this approach by deeming relevant the "total effect" of the transaction giving rise to the benefit. An important point is that the benefit must be significant or material enough to induce acceptance.

Country Road shares have skyrocketed this year and the A$17 per share offer by Woolworths is far in excess of the below $5 prices of January. If Woolworths succeeds with Country Road Lew will certainly benefit, but this benefit would clearly not be available to his fellow DJs shareholders.

If Lew then falls into line with the Woolworths plan for DJs, the question is whether he was "induced". It is uncertain which of Woolworths or Lew has been doing the courting, but both are set to gain.

The need for transparency

Takeovers are regulated under the Corporations Act, which aims to ensure they take place in an efficient, competitive and informed market. It also reinforces the rights of takeover target shareholders to a "reasonable and equal opportunity to participate in any benefits accruing" as a result of a proposal to acquire a substantial interest.

While the concepts of benefit and inducement seem likely to be relevant to Lew's position, it must be noted that the Act focuses on "the bid" and "the bid class", both of which are in terms of a takeover rather than a scheme of arrangement as is most likely to eventuate between Woolworths and DJs.

However, this is not the only provision relevant to the issue of a collateral benefit. Even if the offering or giving of a collateral benefit does not contravene section 623 of the Act, it may still amount to unacceptable circumstances if the benefit offends the principle of equality found elsewhere the Act (section 602).

The Takeovers Panel assesses the principle of equality by considering the commercial balance of advantages flowing to and from the security holder. Whether a transaction is likely to induce an acceptance is assessed by looking at the following: would the transaction affect the shareholders attitude to the acquisition; is the transaction distinct from the bid; is the timing of the transaction relevant and; evidence of net benefit.

The broader position of both ASIC and the Takeovers Panel in relation to the application of collateral benefit prohibitions is a positive step in ensuring market transparency.

It depends if the deal stays friendly…

Although at present the relationship between Woolworths and DJs seems friendly enough, if a scheme can't be agreed upon Woolworths may resort to a takeover bid. In these circumstances where benefits have accrued to Lew they will need to be disclosed in the bidder's statement.

If Woolworths is successful in both of its goals of acquiring all of Country Road and then DJs, Lew looks certain to make a substantial net gain, mostly as a result of his Country Road holdings. Whether this is a collateral benefit in breach of the Corporations Act or just good business will depend on several factors including the timing of Woolworths' impending push for control of DJs, the attitude of minority DJs shareholders if a scheme does eventuate, ASIC's approach to its role in policing the area, and obviously the evidence as to the crucial arrangements.