ISSUE 1 JULY 2001

Allens Arthur Robinson

FOCUS

MERGERS & ACQUISITIONS

Innovative Structures – Dual Listed Companies

Inside:

What is a DLC structure?

Benefits of a DLC structure

Risks of a DLC structure

Key features of a DLC structure

Our experience

Why Australia needs innovative structures for cross-border mergers

Two of Australia's largest corporate transactions were announced during the first quarter of 2001, BHP/Billiton and Brambles/GKN. Both transactions were structured as dual listed companies (DLC) mergers. Although first seen in Australia in 1995 with RTZ/CRA, these transactions have caused renewed interest in this innovative structure for cross-border mergers.

What is a DLC structure?

The DLC structure is a series of contractual arrangements between two listed entities under which they operate as if they were a single economic enterprise while retaining their separate legal identities, tax residencies and stock exchange listings. The result is that the shareholders of each entity are in substantially the same position in terms of votes, dividends and capital returns as if they held shares in a single economic enterprise controlling the assets of both entities.

Benefits of a DLC structure

Although the DLC structure is often described as novel, there are real benefits for cross-border arrangements. These include the following.

- It provides the benefits of scale, merger synergies and continuity of franking without the need for a disposal or transfer of shares. There are no capital gains tax or stamp duty issues and pre-emptive rights in favour of third parties are less likely to be triggered. In addition, no shareholder is forced to sell or exchange their shares.

- The DLC structure permits a nil (or low) premium combination as no party is paying for control of the other.
- Importantly, there is no loss of national identity or corporate status for either DLC entity.
- Merger accounting may be available (subject to ASIC policy). This means that the post-implementation balance sheet may not need to account for goodwill.
- It avoids the problem of flowback often found in other cross-border merger forms, where shareholders sell the foreign scrip for reasons such as portfolio investment restrictions, the desire for franking or simple discomfort with a foreign stock. This can result in pressure on price and change in national ownership profile.
- Particularly important for Australian entities seeking growth, the DLC structure provides improved access to capital markets and a choice of currencies for future global acquisition opportunities.

Risks of a DLC structure

The DLC structure will not necessarily be appropriate for all proposed mergers and there are risks. These include the following.

- When compared with short-term business plans on a stand-alone basis, analyses have shown that the DLC structure can result in earnings per share dilution in the short term.
- The DLC structure is more complex than a stand-alone or holding company arrangement. This complexity results from both the governance and administration requirements as well as compliance with two different legal and accounting regimes (at least for cross-border arrangements).
- It is usual for the DLC structure to require each entity to pay matching dividends on a per share basis. If either entity is unable to declare or pay a matching dividend, the boards may agree a reduced dividend. Alternatively the entities may enter into transactions with each other so as to enable matching dividends, but doing so may have adverse taxation consequences.
- The cross-guarantees will mean that each entity will be exposed to the credit risks of the other.
- The voting interests of the shareholders of each entity on actions which affect them in similar ways will be diluted by the votes of the other group of shareholders. In addition, where each group of shareholders have divergent interests, one entity will not be able to proceed with any proposed action (which might otherwise benefit that entity's shareholders) without separate approval from the other entity's shareholders.
- The DLC structure will often introduce one entity's business to new risks, laws and regulations to which it had no previous exposure; and its shareholders to new assets and territories.

Key features of a DLC structure

Some of the key features of this structure are:

- **Equalisation Ratio.** The ratio of economic and voting interests attaching to an ordinary share in one entity relative to the economic and voting interests attaching to an ordinary share in the other entity after implementation of a DLC structure is called the *Equalisation Ratio*. It is the Equalisation Ratio that governs the proportions in which dividends and capital distributions will be paid on the shares in each company relative to the other. Upon commencement of a DLC structure, the Equalisation Ratio will normally be 1:1.
- **DLC Equalisation Principles.** In a DLC structure it is usual for each entity to ensure, as far as practicable, that all ordinary shares enjoy economic returns and voting rights in the combined group in proportion to the Equalisation Ratio. Where a proposed action by either entity would not have this effect, then:
  - (i) an action must be undertaken to ensure that the economic and voting rights of shares in each entity are maintained in proportion to the Equalisation Ratio; or
  - (ii) an adjustment must be made to the Equalisation Ratio; or
  - (iii) the proposed action must be approved by a separate vote of each group of shareholders.
- **No transfer of assets.** The implementation of a DLC structure does not involve any transfer of assets between the groups of each entity. This is because the contractual arrangements allow equality of treatment of shareholders following implementation. Going forward, assets will be acquired and owned by the member of the combined group for which it is most efficient and appropriate to hold those assets at the time.

- **Identical boards.** Each entity will operate and be managed as if it were part of a single unified economic enterprise with the two boards of directors comprising the same persons and a unified executive management team. Importantly, in addition to its duties to its own company, each board will be authorised to have regard to the interests of both groups of shareholders in managing the combined group.
- **Cross-guarantees.** Under the DLC structure, each entity gives a guarantee (subject to certain exceptions) of future contractual obligations of the other with effect from implementation. These guarantees ensure that creditors will, to the extent possible, be placed in the same position as if the debts owed to them by the one entity were instead owed to them by the combined group. This should ensure a single credit rating for the combined group.
- **Voting arrangements.** Special voting arrangements operate so that the shareholders of each entity effectively vote as a single decision-making body on matters which affect both groups of shareholders in similar ways. Actions relating to matters where each group of shareholders have divergent interests require the separate approval of each group. These voting arrangements are effected through special voting shares, a voting agreement and the constitutions of each entity.
- **Takeover restrictions.** The constitution of each entity also provides that a person (or a group of persons) cannot gain control of one entity or of the combined group other than by making an offer to the shareholders of both entities on equivalent terms or with the relevant board's consent.
- **Liquidation.** Equalisation arrangements on liquidation exist to ensure the equal distribution of any surplus assets on a per share basis to ordinary shareholders of both entities.

Colin Smith, Senior Associate

Vijay Cugati, Solicitor

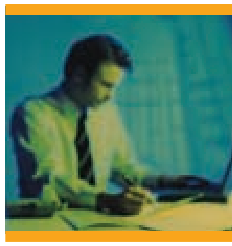
Our experience

Allens Arthur Robinson have been the primary Australian legal advisers in all of Australia's three DLC structures – BHP/Billiton, Brambles/GKN and RTZ/CRA. Peter Cameron, lead partner for the BHP/Billiton and Brambles/GKN transactions, has been named Australian Business Lawyer of the year 2001-2002 by London-based legal researchers Chambers and Partners.

BHP Billiton merger – At A$58 billion, this represents the largest merger in Australian corporate history. A time-critical, highly complex and document intensive transaction, BHP Billiton adopted an innovative dual listed companies structure used successfully only once before in Australia.

Brambles/GKN merger – We are acting for Brambles on its merger with the industrial services business of the United Kingdom's GKN to create a A$20 billion international services group. The demerger and novel refinancing aspects added a further layer of complexity to this dual listed companies structure.

Australia's first dual listed companies structure – We helped Rio Tinto Ltd (formerly CRA Ltd) and RTZ plc (now Rio Tinto plc) structure and establish the world's largest mining enterprise and Australia's first dual listed companies structure. We devised unique and innovative features to obtain the major benefits of a merger, while preserving the advantages of each listed company continuing its separate existence.



ISSUE 1 JULY 2001

Allens Arthur Robinson

Why Australia needs innovative structures for cross-border mergers

'Every year, usually in late January, an M&A sage will be quoted in the financial press predicting another record year for takeovers and mergers. On the basis of the first quarter of 2001, the sage will be proven correct. Activity levels have increased and the dollars involved have become much larger.'

'Globalisation has been a significant element in this increase of M&A activity and with it comes the desire of Australian companies to be a driver and not a victim of the process. Merger restrictions under the Trade Practices Act taken together with mature domestic markets of limited size have meant that Australian companies have had to look offshore for growth through acquisition. Inefficiencies in the tax system have meant that many Australian companies with significant foreign earnings are thinking about restructuring and relocating offshore. The benefit of access to foreign capital markets and the importance of inclusion in foreign market indices mean that, in cross-border mergers, Australian companies are frequently targets rather than acquirers. The forces are vicious ones for Australia. Concerns that many long-established Australian companies risk disappearing from the All Ordinaries index and the apparent relegation of Australia to 'branch office' economy status have been accompanied by calls for regulatory overhaul.'

'Australian companies therefore need to find a way to perform on the world stage while ensuring the maintenance of an Australian identity and culture and the facility for Australian shareholders to invest.'

'That means renewed focus upon innovative structures for cross-border mergers of which the Dual Listed Companies (DLC) structure is the best current example.'

Peter Cameron, Practice Leader, Mergers & Acquisitions, Allens Arthur Robinson
(From *Focus On Mergers & Acquisitions* May 2001)

For further information contact:

Peter Cameron
Partner, Sydney
M&A Practice Leader
Phone: +61 2 9230 4962
Peter.Cameron@aar.com.au

Steven Cole
Partner, Perth
Phone: +61 8 9488 3743
Steven.Cole@aar.com.au

Andrew Knox
Partner, Brisbane
Phone: +61 7 3334 3356
Andrew.Knox@aar.com.au

Larry Magid
Partner, Taxation, Sydney
Phone: +61 2 9230 4918
Larry.Magid@aar.com.au

Cameron Rider
Partner, Taxation, Melbourne
Phone: +61 3 9613 8900
Cameron.Rider@aar.com.au

Jon Webster
Melbourne
Phone: +61 3 9613 8832
Jon.Webster@aar.com.au

Sydney
Melbourne
Brisbane
Perth
Gold Coast
Port Moresby
Singapore
Hong Kong
Jakarta
Shanghai
Bangkok
Phonm Penh

www.aar.com.au