

[Draft for Public Comment – May 2002]

Summary

Although decisions concerning corporate action are generally the responsibility of a company's directors, decisions about control and ownership of the company are usually made by its shareholders. Where a corporate action could affect a proposal concerning control or ownership of a company, the Panel will generally give effect to shareholders' right to determine the control and ownership of the company. The Panel expects that target company directors will act appropriately in such situations and that references to the Panel on these matters will not be common.

Action taken by a target company is likely to frustrate a takeover bid if taking that action has a material effect on the objective of the bid. It will usually allow the bidder either to rely upon a condition in its offer, causing the offer to lapse, or a bidder not to proceed with a bona fide potential offer.

Not every action taken or proposed to be taken by target company directors which may frustrate an offer will give rise to unacceptable circumstances. In each case whether unacceptable circumstances exist will depend on the particular facts being examined.

Neither the Corporations Act nor the common law expressly prohibits a target company board from taking action or agreeing to take action that may frustrate a takeover offer. In some cases, target company directors' duties under the Corporations Act and at common law to act for proper purposes and in good faith in the best interests of the company as a whole may indicate a path of action which could have the effect of frustrating a bid.

Frustration of a bid may give rise to unacceptable circumstances if the particular circumstances offend against the principles set out in sections 602 and 657A of the Corporations Act, even if it is otherwise legal or required for the proper performance of the directors' duties. In such a case, the Panel may prevent the target from proceeding with the frustrating action, unless it has first been approved at a general meeting of target shareholders, or the target has taken some other action to avoid the action being unacceptable.

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Outline of policy to be applied

1. In this Guidance Note¹, the Panel indicates the approach it will take when considering actions of the directors of a company which is subject to an offer or bona fide potential offer (“*offer*”), where those actions may lead to the offer lapsing, being withdrawn or not proceeding. It does not comment on the legal validity or enforceability of particular actions.
2. For this purpose, a *potential offer* is an offer the terms of which have been communicated to target directors publicly or privately by a bona fide bidder, but is not yet a formal offer under Chapter 6 of the Corporations Act.²
3. *Triggering action* is action that triggers a defeating condition of an offer (a precondition, in the case of a potential offer), such that the bidder may allow the offer to lapse or not make the offer, or in the circumstances, ASIC might allow the bidder to withdraw its offer.³
4. In formulating its approach, the Panel has sought not to be prescriptive. Rather, it seeks to provide the market with guidance as to relevant considerations the Panel will take into account when assessing whether triggering action by a target gives rise to actual or potential unacceptable circumstances. The triggering action may be completed or proposed, and may be in the context of a particular offer or other transaction affecting control.
5. Whether circumstances are unacceptable depends on their effect on shareholders and on the market, in the light of the policy of sections 602 and 657A. It does not depend on any intention to bring about an objectionable state of affairs.

Legislative basis for policy

6. This note concerns the principle set out in paragraph 602(c) that:

“as far as practicable, holders of the relevant class of shares ... all have a reasonable and equal opportunity to participate in any benefits accruing to the holders through any proposal under which a person would acquire a substantial interest in the company ...”.

¹ The issues relating to Frustrating Action may overlap with those of Lock Up Devices. Readers of this Guidance Note may also wish to consult the Panel’s Guidance Note on Lock up Devices.

² Except where otherwise specified, legislative references are to the *Corporations Act 2001*.

³ See section 652C and Practice Note 59.

7. Under section 657A(3) the Panel is directed, when considering the purpose set out in section 602(c) in relation to the acquisition of a substantial interest in a company, to:

“take into account the actions of directors of the company ... (including actions that caused the acquisition or proposed acquisition not to proceed, or contributed to it not proceeding).”

8. The Panel has the power to declare that unacceptable circumstances exist in relation to a particular situation and, where appropriate, to make such orders as it sees fit, having regard to the principles set out in sections 602 and 657A(3). It may also make interim orders without making a declaration where, for instance, unacceptable circumstances are impending.

Bidder’s right to define conditions

9. Under Australian law, a bidder is entitled to impose defeating conditions on an offer to acquire a target, with specified exceptions.⁴ Often, a bidder includes conditions in order to protect itself from having to proceed if it receives less than some minimum level of acceptances, does not receive specified statutory approvals or there are material changes to the capital structure, assets or business of the target.
10. A bidder cannot rely on breach of a condition that is itself contrary to Part 6.4 as supporting an argument that the target’s actions give rise to unacceptable circumstances. An example might be a condition whose satisfaction is subject to a whim, or under the control, of the bidder.
11. A bidder must set out the conditions of its offer clearly⁵, or assume the risk that the Panel may not consider that particular triggering action of which it later complains gives rise to unacceptable circumstances.
12. The Panel will not support bidders seeking tactically to exploit the Panel’s guidance on Frustrating Action by making bids subject to long, complex and restrictive lists of defeating conditions.

Directors’ Duties

13. Fiduciary duties of directors are dealt with separately under corporate law. Those duties, at common law and under the Corporations Act, require directors (amongst other things) to act in good faith and for proper purposes and in the best interests of the company as a whole. The Panel’s

⁴ See Part 6.4 of the Corporations Act.

⁵ A bidder should summarise the conditions to its offer in any announcement of an intention to bid. Of course, these conditions must then be fully set out in the offer.

role, however, is not to enforce the law of directors' duties – that role remains with the courts.

14. However, this Guidance Note looks generally to the effect of triggering action on an offer. On that basis, frustrating actions that the Panel would likely consider to constitute unacceptable circumstances may also be found separately by a Court, to constitute a breach of directors' duties. In such cases, the Panel will look to the circumstances of each matter in considering whether it is appropriate for it to conduct proceedings or to allow the issues to be considered in another forum.⁶
15. Neither the Corporations Act nor the common law expressly prohibits a target company board from taking action (or entering into an agreement to take action) that may trigger the conditions of a takeover offer. In general, the law also does not require a target company to obtain shareholder approval prior to entering into such a transaction. However, when a company is subject to an offer, in the circumstances envisaged by sections 602(a) and (c) and 657A(3), the Panel may constrain directors from taking corporate triggering actions.
16. The Panel is primarily concerned with the likely effect of triggering action on the target shareholders' ability to decide on the offer as an alternative to the board's proposal, rather than whether the target directors have complied with their duties to the target company.
17. In exercising its functions and powers conferred by the Corporations Act, the Panel may override directors' decisions where those decisions may interfere with shareholders' opportunity to consider an offer. The Panel may do so even where the triggering action exhibits no want of good faith and is consistent with their duties as directors.
18. It is generally not inconsistent with their duties and with the policy of Chapter 6 for target directors to seek alternatives to a bid. They may consider that shareholders' interests are best served by seeking an offer from another bidder or formulating a competing proposal of another kind, without inhibiting the first bidder from continuing or making its offer. If

⁶ During a bid period, section 659B provides that only ASIC may initiate court proceedings in relation to the bid. It may be that the Panel decides that issues brought before it, which cover both unacceptable circumstances and directors' duties, require determination during the bid, in which case it would act. Alternatively, it might consider that the issues, although potentially unacceptable, could reasonably wait until the bid concluded and then be better dealt with by the courts as a directors duties issue. In which case it might decline to commence proceedings. Alternatively, in some cases (albeit most unusual), the Panel might encourage ASIC to initiate, or facilitate, court proceedings in relation to the directors' duties issues during the bid (although such proceedings may well not conclude during the bid period).

they do this, they are likely to facilitate a competitive market for the control of the target consistent with the principle set out in section 602(a).

19. The Panel will be less likely to consider unacceptable circumstances exist where target directors act in good faith to solicit competing proposals for the target. This is notwithstanding that such action might breach a condition of the original bidder's offer, particularly if those conditions are overly extensive or restrictive (see also paragraph 12 above).

Support from law and ASX Listing Rules

20. The Corporations Act and the ASX Listing Rules in some circumstances require shareholder approval for certain transactions that affect control, or with related parties or associates of the company and its directors. The existence of these analogous constraints supports the Panel's approach when considering what may constitute unacceptable circumstances.
21. In particular, ASX Listing Rules, which ASX administers and enforces, require shareholder approval when significant changes are made to the company, for example:
- (a) the acquisition or disposal of a substantial asset to a person in a position of influence (Rule 10.1);
 - (b) a change in main undertaking of the company (Rule 11.2);
 - (c) disposal of a major asset to a company intending to list on ASX (Rule 11.4);
 - (d) when changes are made to the company's capital structure by the issue of more than 15% of capital currently on issue (Rule 7.1);
 - (e) the issue of shares if 50% of shareholders call a meeting to remove the company's directors (Rule 7.6); and
 - (f) the issue of shares within three months of written notice of a takeover proposal (Rule 7.9).

Policy considerations

22. The Panel's role in making declarations and orders is not to enforce the rights and obligations that already exist between parties. That is for the courts. Rather, the objective of the Panel's decisions is to create new rights and obligations between parties by making orders the Panel considers

appropriate, having regard to considerations of legislative and commercial policy.⁷

23. Whether unacceptable circumstances exist depends on the particular facts of each case. The Panel will only exercise its power to declare that triggering action that frustrates an offer has given rise to unacceptable circumstances in appropriate cases that meet the criteria set out in sections 602 and 657A(3).
24. In determining whether particular triggering action leads to unacceptable circumstances, the Panel will consider the defeating conditions (or preconditions) of the offer in the light of any clearly stated objectives of the bidder in relation to the target. The Panel will also consider whether the action triggers a defeating condition of the offer in a commercially significant way or whether the trigger is merely technical and is unlikely to affect the bidder's objectives for the target.
25. In considering what transactions proposed by target directors may give rise to unacceptable circumstances, some assistance is provided by comparable legal and regulatory requirements for shareholder approval of certain transactions.
26. The circumstances surrounding an offer and any triggering action will affect whether the action frustrates the offer and gives rise to unacceptable circumstances. For example, action that frustrated an offer that demonstrably had very little chance of proceeding or succeeding would be less likely to constitute unacceptable circumstances. This would particularly be so where the target board is able to demonstrate that the triggering action clearly represents significant value for the target.
27. The following factors may also be relevant (but are not an exhaustive list of relevant issues for any particular matter):
 - (a) the period for which the offer has been open⁸;
 - (b) the level of acceptances under the offer⁹;
 - (c) the status of the conditions in the offer;

⁷ See the decision of the High Court in *Precision Data Holdings Ltd v Wills* (1992) 173 CLR 167

⁸ Frustrating action that is undertaken several weeks into a bid where the bid has received few acceptances would be less at risk of a declaration of unacceptable circumstances than action taken before target shareholders had had adequate time to consider the takeover bid.

⁹ Very low levels of acceptance, after a reasonable period to consider the bid, may indicate that the target shareholders have rejected the takeover proposal, and may make frustrating action less likely to be unacceptable.

- (d) whether the bidder can waive those conditions;
 - (e) whether there is a competing offer; and
 - (f) whether the market is trading above the bid price.
28. These factors will normally have less significance during the period up to and immediately after announcement of the offer and during the initial offer period. During this period, the offer is still new to the target shareholders and will have been open for only a short period of time. Consequently it will more difficult for a target board to demonstrate before the Panel that the triggering action should be allowed to frustrate the new offer.

Examples of unacceptable circumstances

29. Some examples of actions which might give rise to unacceptable circumstances include:
- (a) issuing new shares or repurchasing shares, if significant in the context of the target's issued capital and the structure of the bid;
 - (b) issuing securities convertible into bid class securities or options over bid class securities;
 - (c) acquiring or disposing of a major asset;
 - (d) undertaking significant liabilities (e.g. guaranteeing parent company debt);
 - (e) declaring a special or abnormally large dividend; or
 - (f) changing company share plans.

Action that may not give rise to unacceptable circumstances

30. In general, a target will not give rise to unacceptable circumstances by undertaking triggering action that is part of the ordinary course of its business or by carrying out agreements which were entered into or announced before the bid was made known to the company. In these respects, a bidder must accept that the target's normal business will continue, and therefore the target will continue to change to a certain degree. That may include completing contracts already entered into in the ordinary course of the target's business.

31. However, it may be that transactions which materially alter the target's business, or a particular unit of the business, (for example the sale and purchase of a significant asset or business unit) form part of the target company's business plan and might be considered part of the target's ordinary course of business. In those situations, the Panel will balance the nature of the triggering action with its potential effect on the bidder's stated or publicised objectives in relation to the target in determining whether unacceptable circumstances exist.
32. If target boards want the Panel to accept that transactions, announced or entered into after a bid has been announced, are part of the target's normal business, they will need to demonstrate this to the Panel. The more material the size or nature of the transaction, the higher will be the onus on the target board to show that they come within the ordinary course of the target's business or are not properly the concern of the bidder.
33. Triggering action will not normally give rise to unacceptable circumstances, if it is taken by a target to comply with a court order, legislative requirement or Government directive.
34. In addition, triggering action will not normally give rise to unacceptable circumstances if there is a commercial or legal imperative for the target to take that action. The Target may be seeking to avoid some material adverse financial effect or to meet an obligation which, if not performed, may result in materially adverse legal action against the target.
35. An action may lead to an offer lapsing without giving rise to unacceptable circumstances if it does not materially affect the financial or business position of the company (e.g. buying back a small number of shares in the face of a condition that no share buy back be undertaken by the target).
36. The fact that a bidder is entitled to rely on a condition of its offer being triggered by the target's action does not mean that breaching the condition automatically leads to unacceptable circumstances, particularly if the condition is overly extensive or restrictive.
37. Similarly, in general it will not be unacceptable for a target to decline to satisfy a condition that the target enter into material transactions which are not part of its ordinary course of its business or contemplated by its business plan. This is not to suggest that it is always inappropriate for a bidder to announce a bid subject to such a condition.
38. Pre-emptive action taken by directors in the absence of an offer which is designed to protect against a change of control (sometimes known as a "poison-pill") is not considered in this guidance note. However, any such

measure taken whilst target directors are in receipt of an offer falls within the ambit of this policy.

A Better Deal?

39. A target company's directors may consider that a proposed course of action is clearly in the target's interests, because it potentially offers materially greater value for the target compared to the offer. They may consider that it is preferable even though it may trigger a defeating condition of an offer. In such a case, it may, on balance, be the duty of directors and entirely consistent with the policy of Chapter 6 for them to attempt to secure that value for the company. (See also paragraph 17.)
40. However, it is possible for a conflict to arise between the interests of directors of a target company and their duty to act in the best interests of the company. Accordingly, directors of a target should proceed with caution (and independent advice) when considering action that has the potential to frustrate an offer.
41. Target directors may avoid the possibility that any triggering action they propose could give rise to unacceptable circumstances in a number of ways that balance the objectives of Chapter 6 with the directors' obligations to the company. In particular cases, these may include:
- (a) entering into an agreement which is subject to a condition that the bid fails or which contains a cooling-off clause which a new management might exercise,
 - (b) the directors may announce that they will enter into an agreement after a specified, reasonable time, unless control has by then passed to the bidder,
 - (c) seeking prior shareholder approval; or
 - (d) making triggering action conditional on obtaining shareholder approval.
42. Where practicable, these approaches would allow shareholders to make a choice between the offer and the triggering action proposed by the target. This gives effect to the principle that shareholders have reasonable and equal opportunities to participate in any benefits accruing under an offer.

Time constraints

43. In some limited circumstances a transaction may be lost because of the time implications of calling a general meeting. For example, an

opportunity may present itself to the target board which it considers it is likely to be in the company's best interests to pursue, but which may only have a short window for acceptance or completion.

44. Generally, the Panel will not consider a threat to withdraw by the counterparty to the proposed transaction to be sufficient to prevent the triggering action giving rise to unacceptable circumstances. The Panel will require the target to present evidence as to:
- (a) the value lost or cost to the target of losing the transaction;
 - (b) the reasons that the transaction must be completed before a general meeting could be convened to consider the transaction; and
 - (c) the reasons why the transaction cannot be conditional on shareholder approval or alternatively, the offer failing.

Preventative steps a bidder and target may take

45. A bidder that is in private discussions with a target regarding a possible offer should make clear to the target what conditions would or might apply if such an offer were to be announced. Simply being in talks will not be sufficient for a bidder to demonstrate the existence of a bona fide potential offer. Nor will it be sufficient that the offer would be subject to relevant conditions, and consequently that triggering action gives rise to unacceptable circumstances. This will be important if there is a later application before the Panel where the bidder may need to demonstrate that the target was aware of certain conditions that are in issue.
46. An announcement of an intention to make an offer normally includes a summary of the significant conditions that will apply to the offer when it is made. A bidder should be mindful of this guidance note when formulating such a summary (see paragraphs 11 and 12 of this Guidance Note).
47. The Panel expects that if an application is made to it alleging that unacceptable circumstances have arisen because an offer has been or will be frustrated by the triggering action, directors will be able to provide evidence of the process and reasons for its decision to take that action.

Extending the Bid to Allow Offerees the Choice

48. If a target proposes action that the bidder considers, or is likely to consider, to be frustrating, the target may offer to seek its shareholders' decision on the proposed action. This would allow shareholders to decide, on adequate information, and with adequate time, on the two competing

proposals. However, it is unlikely that the target could convene and hold a shareholder meeting within the one month for which most bids are initially open.

49. The Panel would be less likely to make a declaration of unacceptable circumstances against a target company where it had offered to seek shareholder approval and the bidder had declined to extend its bid to beyond a date reasonably required by the target to prepare the required notice of meeting and convene the meeting. Similarly, a Panel would be more likely to declare frustrating action to constitute unacceptable circumstances where a bidder had offered to extend its bid in such a manner and the target company did not seek shareholder approval.
50. The Panel's decision in such circumstances will depend particularly on the circumstances of the individual matter. The Panel will consider issues such as: what is a reasonable period of time for the target to prepare the notice of meeting, how long has the target been considering the proposed action, and what are the benefits to target shareholders of the proposed action.

If Shareholders Consider Triggering Action

53. If shareholders approve triggering action in general meeting that may otherwise have frustrated an offer and led to unacceptable circumstances, the bidder will normally have the choice of allowing its offer to lapse or waiving the condition. If it is too late to waive the condition, or if it is unwaivable, the offer will close with the condition unfulfilled.
54. If the target puts a resolution before its shareholders to approve certain triggering action and the resolution fails, the Panel will usually require a bidder who has made an application in relation to that action, to agree not to rely on the fact that the action was submitted to the general meeting as triggering a defeating condition of its offer. This may require the bidder to take action to ensure that the relevant condition is not invoked and that the offer is not affected by the condition technically having been triggered, for instance by varying or waiving the condition.

Remedies

51. The Panel has wide powers to make orders under section 657D if it finds that triggering action by target directors gives rise to unacceptable circumstances. This includes preventing an action or transaction from proceeding or requiring the target to seek shareholders' approval of the action or transaction in general meeting.
52. The Panel's remedies will be aimed at ensuring that:

- a. target shareholders are given a reasonable opportunity to consider the merits of competing proposals which may affect control and deciding between them, and
- b. ensuring a takeover proceeds, as far as possible, in a way that it would have done if the unacceptable circumstances had not occurred.