

Public Consultation Response Statement dated 16 June 2003

1. INTRODUCTION

- 1.1. On 31 May 2002, the Takeovers Panel released for public comment a draft Guidance Note on Frustrating Action (GN). Comments were due by 12 July 2002.
- 1.2. This paper sets out the Panel's response to the public consultation process.
- 1.3. The Panel received nine submissions from private persons and bodies in response to the draft Guidance Note. The Panel wishes to express its gratitude to these persons and bodies for their valuable feedback.
- 1.4. The sections below set out feedback under two categories: general comments relating to the overall GN (section 2) and specific comments on particular issues in the GN (section 3).
- 1.5. Respondents' general comments can be grouped into the following categories:
 - those who generally agreed with the overall policy;
 - those which believed that the Panel should go further, effectively always requiring shareholders to approve triggering action; and
 - those who opposed the GN on the basis that it inappropriately impinged on directors' duties and/or that the Panel had insufficient legislative power to publish the GN.

GENERAL COMMENTS

The comments in this section are set out, and responded to, together.

No.	Comments expressed
1.	<p>One group of respondents broadly supported the GN, including the view that frustration of a bid gives rise to unacceptable circumstances if the particular circumstances offend the principles in sections 602 and 657A, even if the conduct is otherwise legal.</p> <p>This group of respondents agreed that it is not the Panel's role to enforce the law of directors' duties, and that frustrating action may arise without a breach of duties. However, one respondent stated that it doubted whether action required for the proper performance of directors' duties would be likely to create unacceptable circumstances. In most cases, the requirements of the GN would be compatible with what might be expected of directors acting consistently with their duties.</p>
2.	<p>One group of respondents submitted that shareholder approval should always be mandatory in cases involving a triggering action, other than in extenuating circumstances.</p>
3.	<p>Some respondents argued that directors' duties should prevail over any perception of unacceptable circumstances. They argued that the GN inappropriately limited directors' freedom under the traditional "proper purpose" test of taking actions in response to a hostile bid which are designed to maximise value for target shareholders. They submitted that:</p> <ul style="list-style-type: none"> • target directors are best placed to maximise value for target shareholders in response to a bid; • the Panel's approach appeared to be driven by its resourcing and difficulties in establishing improper purpose; and • a better approach would be to examine the target directors' motives and intentions in taking the action that they did.

No.	Comments expressed
4.	<p>Some respondents submitted that the Panel should not impose a requirement of shareholder approval where the Corporations Act (Act) or Listing Rules did not expressly impose the requirement.</p> <p>They further argued that:</p> <ul style="list-style-type: none"> • section 602(c) of the Act did not support the GN. That paragraph was designed to ensure that <i>if</i> a merger proposal was made, it was made to all holders in the relevant class, not to ensure that the merger proposal was made, or not remove obstacles to the making of the proposal. • Chapter 6 regulates the relationship between each target shareholder individually and a bidder. It is inappropriate to subject an individual's relationship with a bidder to a decision by the shareholders acting as a body.

Panel's response: The Panel decided to maintain the general substance and form of the draft GN.

Many submissions endorsed this approach. There was also support for it in the London City Code, the Hong Kong Code and the EU proposals. Most importantly, the policy is supported by section 602(c) of the Act, as extended in its application by section 657A(3). Those sections are not limited to ensuring equality of opportunity once a bid has been made – they also seek to ensure that shareholders have a reasonable opportunity to participate in any benefits accruing to holders through any proposal under which a person would acquire a substantial interest in the company. Frustrating action can also obstruct the objective of an efficient, informed and competitive market within section 602(a).

The Panel's approach is not based on difficulties in establishing improper purpose. Rather, its approach is based on legislative policy which requires the Panel to examine the effect of behaviour on shareholders and markets, rather than subjective factors or its interpretation of the motives or purpose of conduct before it.

SPECIFIC COMMENTS

The comments in this section set out material comments received on specific paragraphs or issues in the GN. The Sub-Committee's response is set out alongside the comment.

No.	Para.	Comment	Panel response
Issue: Bidder's right to define conditions			
1.	12 ¹	It may be helpful for the GN to state expressly that the Panel does not object to the use of detailed and complex conditions provided the bidder has a genuine commercial justification for the condition.	This paragraph seeks to limit the bidder's potential abuse of the frustrating action policy, rather than to limit the use of detailed, complex or restrictive conditions where they are commercially justified. Paragraph 12 was amended to make it clear that the Panel will generally not invoke the frustrating action policy where a bidder imposes conditions without any genuine commercial justification.
2.	12	The GN should more directly address the issue of bidders using restrictive conditions and the threat of a Panel application to pressure target boards into submission.	Paragraph 12 of the GN demonstrates that the Panel will not support applications by bidders who try to exploit the frustrating action policy by using restrictive conditions which do not have a commercial justification.
Issue: Overlap with director's duties			
3.	F/note 6	The Panel states that it may consider applications which involve director's duties, or it may not, or that it may encourage ASIC to act, without establishing criteria for deciding which of these courses the Panel may take.	Footnote 6 makes it clear that the Panel will act if it considers that the issues require determination during the bid. Otherwise it may decide that the issues are better dealt with by the courts after the bid has concluded, or it may encourage ASIC to initiate court proceedings during the bid. The Panel would prefer to maintain flexibility in dealing with this issue, rather than adopting an overly prescriptive approach.

¹ Paragraph numbers refer to paragraphs in the draft GN unless otherwise indicated.

No.	Para.	Comment	Panel response
4.	19	The Panel states that it is less likely to consider unacceptable circumstances where target directors act in good faith to solicit competing proposals. This is inconsistent with paragraphs 13, 16 and 17 which state that the Panel is not concerned with whether target directors have complied with their duties.	The Panel agreed with this comment and made the appropriate changes to paragraph 20 of the final GN.
Issue: Relevance of the bidder's objectives			
5.	24 and f/note 5	<p>The relevance given to bidder's objectives is problematic because:</p> <ul style="list-style-type: none"> it requires a bidder to set out its intentions in relation to a target in its bid announcement (as opposed to in its bidder's statement) which may discourage companies from making bids; it is likely that targets will compare announced conditions against stated objectives to identify the "gaps" in which the target would be free to undertake frustrating action. 	<p>The Panel believes that it is appropriate for it to consider any objectives stated by the bidder in determining whether triggering action gives rise to unacceptable circumstances. However, the GN does not indicate that the Panel requires a bidder to state its objectives in its bid announcement.</p> <p>The second point may be true, but the Panel will take a principles-based approach, rather than an overly technical approach, to interpreting the GN and market participants are encouraged to treat it in the same way.</p>
Issue: Relevance of the likelihood of bid succeeding			
6.	Para 27 and f/notes 8 and 9	Various parties commented on the relevance of acceptance levels in determining whether the bid was likely to succeed as acceptances usually arrive towards the end of the bid period.	Paragraph 25(b) of the final GN has been amended in light of these comments.

No.	Para.	Comment	Panel response
Issue: Action that may not give rise to unacceptable circumstances			
7.	30- 36	There is no 'exceptional circumstances' exception like that proposed by the Panel in Pinnacle 8 – the example given there was of a transaction which was clearly for the commercial advantage of the company and so motivated. Such an exception should be retained in order to provide target directors with some autonomy to respond to a hostile bid.	<p>Presumably all action undertaken by the target board should be for the commercial advantage of the company. The Panel believes that paragraphs 36 to 41 of the final GN give target directors an appropriate level of autonomy to respond to exceptional circumstances. Paragraphs 19 and 20 expressly ensure that the GN does not unduly restrict the target directors in responding to a bid.</p> <p>The Panel considers that a broad exception such as the one proposed would be too wide. The final GN allows some leeway for circumstances of exceptional value at paragraphs 36 and 37 of the final GN.</p>
8.	31 and 32	<i>Any</i> material transaction entered into during a bid or proposed bid should be put to the shareholders. It is irrelevant whether the transaction is undertaken in the ordinary course of business if it is material.	There is a balance to be drawn between preserving the right of shareholders to determine the ownership and control of the company and not limiting unduly the conduct of a target's business while a bid is on foot. The Panel believes that the ordinary course of business exception is appropriate. If a material alteration of the target's business is in the ordinary course of business, the balancing of the factors set out in paragraph 30 of the final GN are appropriate.
9.	32	Paragraph 32 reverses the onus of proof by requiring target boards to demonstrate that transactions announced or entered into after a bid has been announced are part of the target's normal business, as opposed to requiring the complainant to discharge that onus. This has the potential to be abused. It also changes the process of takeover defences and may affect other director's duties.	<p>Whether or not a particular action is within the ordinary course of the target's business is something that the target is best able to show.</p> <p>Further, to the extent that this paragraph acts as a "defence", it is appropriate for the onus of proving the defence to lie with the target (once the bidder demonstrates that the action may constitute unacceptable circumstances).</p>

No.	Para.	Comment	Panel response
10.	32	Better guidance on transactions that the Panel might consider to be a material transaction that affects a target's business would be helpful, in the same way that Rule 21 of the London City Code does.	The Panel considers that the guidance given is appropriate and the materiality concept is generally well understood. The Panel does not wish to take an overly prescriptive approach to this issue.
11.	33	This paragraph should be rephrased to recognise that action required by law will not <i>in itself</i> give rise to unacceptable circumstances.	The Panel made the suggested changes to paragraph 31 of the final GN.
Issue: Obtaining independent advice			
12.	40	One respondent indicated that it interpreted paragraph 40 to mean that the Panel's preferred position is that independent advice be sought. Some guidance on the nature of the independent advice would be helpful.	The Panel provided some guidance in paragraph 37 of the final GN.
Issue: Ways of avoiding a declaration			
13.	41	One respondent commented that the options set out in paragraph 41 are not commercially viable.	<p>The Panel accepts that may sometimes be true, however, the Panel adopted the principle that control decisions should be made by shareholders and target directors need to be mindful of this when there is a bid or a potential bid for the company.</p> <p>The Panel noted that there are measures, short of requiring a shareholder vote, which can satisfy the frustrating action GN. (See paragraphs 28-35 of the final GN which deal with action that may not give rise to unacceptable circumstances and paragraphs 19 and 20 of the final GN which deal with target directors seeking competing proposals).</p>

No.	Para.	Comment	Panel response
14.	2 and 41	<p>Before a takeover bid is publicly announced, target company directors should be entitled to treat a non-public proposed bid as speculative and to conduct the target business without regard to the GN. Many companies are the subject of repeated non-public merger proposals. It may not be possible for a target proposing action which may frustrate a non-public proposal to take the action referred to in paragraph 41.</p>	<p>The suggestion that a target in receipt of a non-public merger proposal may not be able to undertake the options in paragraph 38 of the final GN (because those options would involve the disclosure of the proposal) may be true. However, the Panel believes that paragraphs 28 to 35 of the final GN will enable targets to carry on with their business in the ordinary course in such cases. Further, a target in such a case may offer to put the proposal to shareholders if the bidder announces its intention to make a bid quickly.</p>
Issue: Guidance in relation to a frustrating action approval resolution			
15.	41(c), 49, 53 and 54	<p>The GN should state who is permitted to vote on a frustrating action approval resolution.</p> <p>Some respondents argued that shareholders whose interests were affected by the frustrating action in a capacity other than as a shareholder ought not to be permitted to vote. This would exclude from voting the bidder, competing bidders and counterparty to the proposed frustrating action. Target directors, as proponents of the frustrating action, would also be excluded.</p> <p>Other respondents said that where there are not other applicable requirements under the Act or Listing Rules on voting, all shareholders should be permitted to vote.</p>	<p>At this stage the Panel does not wish to adopt an unduly prescriptive approach to this issue and considers that voting requirements under the Act and Listing Rules will usually provide adequate guidance to the target board.</p>

No.	Para.	Comment	Panel response
16.	41(c), 49, 53 and 54	<p>The GN should set out the level of disclosure to be made in the notice of meeting and explanatory memorandum for the proposed frustrating action.</p> <p>Some respondents suggested that the disclosure test should be similar to the test for the content of a target's statement.</p> <p>Others suggested that the notice of meeting should:</p> <ul style="list-style-type: none"> • Disclose full details of the proposed triggering action; • Discuss the merits of the offer and the triggering action; • Provide an independent expert's report; • Provide a recommendation; and • State whether or not the proposed triggering action may be voidable on the basis that it was or may have been entered into for an improper purpose. If so, it should state that the resolution is intended to cure that possible invalidity by ratification. 	<p>At this stage the Panel does not wish to adopt an unduly prescriptive approach to this issue.</p> <p>Requirements under the general law, the Act or Listing Rules will continue to apply.</p> <p>The Panel does not believe that it will always be necessary for an independent expert's report to be obtained although it will frequently be highly desirable.</p>
17.	41(c), 49, 53 and 54	<p>Any triggering action approved before the announcement of the offer, but not implemented at the time of the offer, should be approved following the making of the offer. This is because of the material change in circumstances caused by the offer being made.</p>	<p>It is quite true that the announcement of an offer may bring about a material change in circumstances. However, the Panel believes that it would be unduly prescriptive to adopt this approach in all cases.</p>

No.	Para.	Comment	Panel response
Issue: Extending the bid to allow shareholders to consider the frustrating action			
18.	49	The GN should provide guidance on the time within which a shareholders meeting to approve a proposed frustrating action should be held, particularly where the target is required or wishes to obtain an independent expert's report.	Paragraph 46 of the final GN makes it clear that meetings should be held expeditiously.
Issue: Remedies			
19.	51 and 52	The Panel should clarify whether it has the power to unscramble a triggering action which is found to create unacceptable circumstances.	<p>The Panel has wide powers to make orders under section 657D(2). The Panel could order the "un-doing" of a triggering action which is unacceptable if this is required to:</p> <ul style="list-style-type: none"> • protect the rights or interests of a person affected by the circumstances; or • ensure that a proposed bid proceeds as it would have if the circumstances had not occurred. <p>Whether such an order would be practical would depend on the circumstances.</p>

Robyn Ahern, Tony Burgess, Kathy Farrell, Irene Lee and Marian Micalizzi comprised the Frustrating Action Sub-Committee

The Panel's website on www.takeovers.gov.au/content/guidance/frustrating_action.asp sets out in full the Guidance Note on Frustrating Action as amended by the Panel following the public consultation process.