



GUIDELINES ON FINANCING ARRANGEMENTS FOR TAKEOVERS

Introduction

1. This Guidance Note sets out the Panel's views on the funding arrangements of takeover bids that may give rise to unacceptable circumstances. The Guidance Note also provides some supplementary guidance on the obligation to disclose funding arrangements in bidder's statements: see also ASIC Practice Note 37 as well as the Panel's decisions in *Pinnacle VRB Ltd (No 6)*,¹ *Taipan Resources NL (No 10)*,² *Taipan Resources NL (No 11)*³ and *Goodman Fielder Ltd.*⁴
2. A bidder should only announce a takeover offer after the most careful and responsible consideration and when the bidder has every reason to believe that it can and will be able to implement the offer.⁵ The overwhelming evidence of current market practice indicates that bidders are acting in accordance with this requirement.
3. The Corporations Act (**Act**) does not explicitly require a bidder making a cash offer to have the cash available to satisfy full acceptance of the offer. However, a person announcing a bid who does not have a reasonable basis to expect that it has in place sufficient funding arrangements is likely to contravene paragraph 631(2)(b) of the Act. This provides that:

*"a person must not publicly propose ... to make a takeover bid if ... the person is reckless as to whether they will be able to perform their obligations relating to the takeover bid if a substantial proportion of the offers under the bid are accepted."*⁶

¹ [2001] ATP 11; (2001) 38 ACSR 564.

² [2001] ATP 5.

³ [2001] ATP 16.

⁴ [2003] ATP 1 (2003); 44 ACSR 254.

⁵ See ASIC Practice Note 59, particularly paragraphs 3-5, 11-12 and 30. This policy is similar to General Principle 3 of the London *City Code on Takeovers and Mergers*. See also section 631 of the Corporations Act, the Panel's decision in *Realestate.com.au.Ltd* [2001] ATP 1 and the decision of Santow J in *Re Archaean Gold NL* (1997) 15 ACLC 382.

⁶ Other jurisdictions explicitly require that funding arrangements be in place. For example, Rule 24.7 of the *City Code* provides that an "offer document must include confirmation by an appropriate third party (eg the offeror's bank or financial adviser) that resources are available to the offeror sufficient to satisfy full acceptance of the offer". See also Item 1007 ('*Source of amount of funds or other consideration*') of Regulation M-A (Mergers and Acquisitions)



4. In most situations, the Act provides sanctions for bidders that fail to pay for acceptances under the bid. In particular, section 588G will ordinarily provide a sanction against directors of a bidder who authorise the dispatch of an offer for which acceptances are not paid due to a lack of funding, where there were reasonable grounds for the directors to suspect that the bidder would be unable to pay.⁷
5. The Panel takes the view that unacceptable circumstances would be likely to exist in each of the following circumstances:
 - (a) a bidder announced a takeover without having either adequate funding arrangements in place, or a reasonable basis for confidence that they would be in place when the bid became unconditional;
 - (b) existing funding arrangements were to fail and not be promptly replaced;
 - (c) a change in the structure of a bid (such as the waiver of a condition) were to render existing funding arrangements inadequate; or
 - (d) a bid were to be declared unconditional when financing arrangements remained conditional on material factors and there was a material risk they would not be fulfilled.Deficient funding arrangements will create unacceptable circumstances because they will lead to a false market in the target's securities, contrary to the policy in paragraphs 602(a) and (b)(iii) of the Act.
6. This Guidance Note sets out factors the Panel will consider when determining whether particular funding arrangements create unacceptable circumstances. This policy must be applied to the particular facts and circumstances of the case in order to determine whether the bidder's funding arrangements are sufficient.

Nature of Funding Arrangements

7. A bidder may choose to fund its bid from internal resources or with borrowed funds; in either case it must be evident that there is a reasonable basis for confidence that the bidder will be able to pay for acceptances under its bid. The bidder's disclosure documents must

(promulgated by the Securities and Exchange Commission under the Securities Act 1933), 17 CFR § 229.1007.

⁷ This section only applies to Australian bidder companies. There are likely to be similar insolvency provisions operating in other jurisdictions.



clearly demonstrate that either it or its lender has the necessary financial resources to satisfy its obligations. If a bidder is a member of a substantial corporate group, a funding arrangement with the parent of the group may be sufficient. See also paragraph 24.

8. If the bidder proposes to pay for shares with borrowed funds, it must have funding arrangements in place with a lender when it announces and makes its offers. Although those arrangements need not necessarily at those times be formally documented⁸ or free of conditions precedent⁹, they need to provide the bidder with a reasonable basis for believing that it will be able to pay for acceptances under the bid. The bidder must also ensure that it discloses sufficient information so that target shareholders have a reasonable basis on which to assess whether they will be paid for their shares if they accept the offer.

Reasonable Basis for Funding Arrangements

9. Whether a bidder has a reasonable basis to expect that it will have adequate funding arrangements in place will depend upon the circumstances. The subjective beliefs of the bidder's directors are less important in this regard than the objective circumstances.
10. Examples of a bidder not having a reasonable basis to expect that it will have adequate funding arrangements in place may include the following situations:
 - (a) the financing is an informal arrangement;
 - (b) the financing remains subject to internal approval by the lender;¹⁰
 - (c) the financing is on a "best endeavours" basis;¹¹
 - (d) the financing has unusual repayment or expiry provisions that may result in the financing not being available to pay for acceptances;¹²
 - (e) the financing is subject to documentation, unless there is an underwriting commitment in place which is sufficiently detailed to

⁸ See for example *Target Petroleum NL v Petroz NL* (1987) 16 FCR 1, *Goodman Fielder* [2003] ATP 1; (2003) 44 ACSR 254, *Pinnacle VRB Ltd (No 6)* [2001] ATP 11; (2001) 38 ACSR 564 and *Taipan Resources NL (No 10)* [2001] ATP 5.

⁹ See for example *ACI Ltd v Rossington Holdings Ltd* (1992) 106 ALR 221 and *Goodman Fielder* [2003] ATP 1; (2003) 44 ACSR 254.

¹⁰ See *Taipan Resources NL (No 10)* [2001] ATP 5.

¹¹ See *Taipan Resources NL (No 10)* [2001] ATP 5.

¹² See for example *ICAL Ltd v County Natwest Securities Australia Limited* (1988) 6 ACLC 467.



- provide the bidder with a reasonable basis for believing that it will be able to pay for acceptances under the bid (see paragraph 8); or
- (f) the lender has insufficient funds to pay for the shares, even if the loan documents are in order.

The existence of any of the above issues may, subject to paragraph 11, give rise to unacceptable circumstances.

- 11. It may be clearly evident that the bidder has access to sufficient funds to pay for acceptances within the required timeframe. For example:
 - (a) the bidder may have clearly adequate cash reserves or undrawn facilities;
 - (b) the bidder may have adequate non-cash reserves and may be relying on the sale or mortgage of those reserves to provide the cash consideration (see paragraph 26); or
 - (c) the bidder may propose to borrow cash in circumstances where it has adequate cash or non-cash reserves which could be used to cover its bid commitment if the finance were not forthcoming.

In these instances, unacceptable circumstances may not exist merely because of the bidder not having binding funding arrangements at all relevant times,¹³ provided that the bidder makes full disclosure of the relevant circumstances, including as set out in paragraph 26. In the circumstances set out in paragraph (c) above, the bidder would need to disclose full details of the funding arrangements as well as full details of the cash or non-cash reserves.

Finance that is subject to approval

- 12. Further to paragraph 10(b), a bidder of substantial worth who reasonably believes that it would have access to other sources of funds may be able to rely on a debt funding facility that remains subject to approval by the lender's credit committee. This will only be the case if the bidder has been informed by the lender that credit committee approval is likely to be obtained swiftly.¹⁴
- 13. Conversely, if the bidder does not have reasonable grounds to believe that it has access to other sources of funds, it is unlikely to be acceptable for the bidder to rely on an informal "commitment" by a financier to provide funds on terms which have not yet been decided. This will be the case even if the bidder's directors believe that the

¹³ See the Panel's decision in *Taipan Resources NL (No 11)* [2001] ATP 16.

¹⁴ See the Panel's decision in *Taipan Resources NL (No 10)* [2001] ATP 5.

financier will meet its commitment.¹⁵ In such circumstances credit committee approval should be obtained and documentation completed and signed (see paragraph 14) prior to the announcement of the offer.

Finance that is subject to documentation

14. Where finance is subject to documentation either when the offer is announced or when the bidder's statement is lodged, the documentation should be completed and signed prior to the offers being sent to the target shareholders. Any material changes to the terms of the finance disclosed in the bidder's statement should be disclosed to target shareholders by way of a supplementary bidder's statement.
15. Ordinarily, the actual loan or other financing documents should be completed and signed. However, a detailed and binding facility or commitment letter that is signed and agreed between the parties and which sets out all of the material terms and conditions may be sufficient documentation.

Amount of Funding

16. If the bid extends to securities that are issued during the offer period,¹⁶ funding arrangements should be sufficient to pay for those additional securities. However, if the bidder has a reasonable basis for expecting that acceptances will not be received in respect of particular securities,¹⁷ its funding arrangements need not extend to those securities.¹⁸
17. If the financing is denominated in a foreign currency, the bidder may need to ensure that there will be sufficient funds available in Australian currency. It may do this either by making hedging

¹⁵ See the Panel's decisions in *Pinnacle VRB Ltd (No 4)* [2001] ATP 7; (2001) 38 ACSR 564 and *Pinnacle VRB Ltd (No 6)* [2001] ATP 11; 38 ACSR 564.

¹⁶ Refer subsection 617(2) of the Act.

¹⁷ For example, because the offeror or one of its subsidiaries already holds securities in the bid class or because there are arrangements under which a shareholder in the target has agreed not to accept the bid or convertible securities are materially out of the money.

¹⁸ The bidder should disclose the basis for its expectation. In certain circumstances, arrangements with target shareholders may be constrained by section 606 of the Act.



arrangements or by being able to demonstrate that the financing will be sufficient even if there is a material adverse exchange rate movement.¹⁹

Disclosure requirements

18. In addition to the matters covered in ASIC Practice Note 37 and the Panel decisions referred to paragraph 1, a number of disclosure issues emerge from the situations referred to above.
19. The bidder must disclose in meaningful, clear language the nature of the funding (and cash) arrangements it has to pay for all the securities to which the bid relates.
20. The financial terms of a funding arrangement (interest rate, repayment and security) do not usually need to be disclosed. However, if the bid may result in a continuing minority shareholding in the target, and the bidder intends to rely on the target for the payment of interest on, repayment of or security for any liability, details of the arrangements contemplated should be disclosed in the bidder's statement. This disclosure may become relevant if the bid is declared free of a minimum acceptance condition.

Conditions Precedent which are beyond the power of the bidder to satisfy

21. While a bid is still conditional and the bid financing has material conditions precedent to drawdown which are beyond the power of the bidder to satisfy, either:
 - (a) corresponding defeating conditions should be included in the bid; or
 - (b) the bidder's statement should disclose clearly and prominently the material conditions to drawdown which are not also defeating conditions.²⁰

A bidder may use each of these alternatives in a bidder's statement to treat different conditions to drawdown in different ways. Another critical time to consider these issues is when the bid is about to become free from its defeating conditions: see paragraph 22.

¹⁹ See *Parker & Parsley Petroleum Australia Pty Ltd v Gantry Acquisition Corp* (1994) 13 ACSR 689.

²⁰ Unless the bidder has a reasonable basis for believing that the finance conditions will be satisfied or waived, this situation may give rise to unacceptable circumstances.



Freeing a bid from conditions

22. Unacceptable circumstances may arise if the bid is declared free from all its defeating conditions when conditions to drawdown that are commercially significant remain or where there is a significant risk that any condition to drawdown might not be fulfilled.²¹ Further, if financing is still conditional at this late stage in the bid, the Panel may be more inclined to treat this as evidence that the bidder did not have (or no longer has) a reasonable basis to regard its funding arrangements as adequate.
23. Where a bid is unconditional but financing is not, the bidder must issue a supplementary bidder's statement which informs shareholders of:
- (a) the current status of the material conditions to drawdown of the financing that remain to be fulfilled; and
 - (b) the likelihood of those conditions being fulfilled.

The Panel considers that unacceptable circumstances may exist where the bidder does not, in addition to the acts required by section 647, bring the relevant material to the attention of the offerees. This should happen preferably by posting a supplementary statement to them or by widespread and clear advertising.

Reliance on cash reserves or pre-existing facilities

24. Where the bidder is relying on its own (or its group's) cash reserves, and they are subject to security interests, rights of set-off or other arrangements that may materially affect the bidder's ability to use the reserves to pay the consideration under its bid, the bidder should arrange alternative finance on a standby basis or have available to it other sources of readily available cash. If the bidder's cash reserves were encumbered in this way and standby finance was not arranged, then the bidder may not have a reasonable basis for believing it would have funds to pay for acceptances of the bid and unacceptable circumstances may be found to exist. This would particularly be the case where the bidder did not reasonably believe that it would have access to other sources of funds.

²¹ The main situation where this will generally not create unacceptable circumstances is where bid financing is subject to a minimum acceptance condition in connection with the bid.

25. Equivalent principles to those set out in paragraph 24 apply where a bidder is relying on drawing down pre-existing facilities to fund its bid and those facilities may not be immediately available or may be required to fund other company operations.

Reliance on asset realisations

26. A bidder may, in certain circumstances, be able to rely on its (or its group's) non-cash resources to provide the cash consideration required under its bid. If a bidder is relying on realising non-liquid assets to fund cash consideration under the bid, it must be able to realise those assets on a timely basis for a cash amount sufficient to pay for all the securities to which the bid relates. The bidder should provide sufficient information about the assets, their value and the proposal to realise them to allow the target's shareholders to assess the likelihood that those assets can be realised to provide sufficient cash in time and should arrange stand by finance. The bidder may not have a reasonable basis for making its bid if it does not arrange standby finance and unacceptable circumstances may be found to exist. This would particularly be the case where the bidder does not reasonably believe that it would have access to other sources of funds.

Changes in Funding Arrangements

27. The bidder's initial funding arrangements need not extend to cover additional amounts that might be required if the bidder were to increase the offer price or offer to pay costs and expenses.²² However, unacceptable circumstances may be created if the bidder increases the bid price or extends the bid to additional securities if it does not have adequate funding arrangements in place to cover the additional expense.
28. Unacceptable circumstances are very likely to exist if a bidder changes either its bid or its funding arrangements and the change materially affects the basis on which accepting offerees, and the market, had been entitled to rely in forming a view on the adequacy of the funding. Examples may include:

²² See *AAPT Ltd v Cable and Wireless Optus Ltd* (1999) 17 ACLC 974, at 1010 and *Associated Dairies Ltd v Central Western Dairy Ltd* (1993) 117 ALR 433, at 439. Cf *Re Archaean Gold* (1997) 15 ACLC 382, at 384.



- (a) declaring an offer free from conditions while material financial conditions remain unfulfilled and not informing the market of that fact or of the likelihood of those conditions being fulfilled; or
 - (b) waiving a minimum acceptance condition, bringing about the situation described in paragraph 21 (with the result that there may be a continuing minority shareholding).
29. A bidder may alter its funding arrangements after it makes its bid if the changes do not materially adversely affect offerees, and the market for target (and bidder) shares generally. Unacceptable circumstances are likely to occur if the new lender lacks the financial resources to satisfy the bidder's obligations.
30. Target shareholders should be able to rely on the disclosures regarding the bidder's funding arrangements set out in the bidder's statement. Material changes to funding arrangements will require prompt, supplementary disclosure by way of a supplementary bidder's statement.
31. Any material change to funding arrangements should be consistent with the terms of this Guidance Note.

Delivery versus payment

32. As the High Court observed in *George Hudson Holdings Limited v Rudder*,²³ the usual rule in transactions involving payment in return for a transfer of property is that the transfer of title to the property only occurs when payment is made, unless the contract provides otherwise. Offers under bids, however, typically contain provisions allowing shares the subject of acceptances to be transferred before payment is made. If payment is not made, accepting offerees become unsecured creditors of the bidder. The Panel considers that unacceptable circumstances would be created if a bidder transferred shares under this kind of clause, for instance by a message to the SCH relating to an acceptance sub-position, and then did not pay the consideration. If that occurred, the Panel would be likely to make orders restoring the shares transferred to the relevant accepting offerees.

Equity funding

33. This Guidance Note focuses on debt facilities used to fund a bidder's obligations under a bid. A bidder might also, or as an alternative, fund those obligations, in whole or in part, by raising equity. The Panel

²³ (1973) 128 CLR 387.



would apply the principles set out in this Guidance Note, with the necessary amendments, to an equity-based funding facility. The Panel is considering whether specific guidance should be given by it on this subject.

30 October 2003.