Takeovers Panel

GUIDANCE NOTE 7: LOCK-UP DEVICES

Overview

This Guidance Note sets out the Panel's approach to lock-up devices such as break fees, asset lock-ups, no-talk agreements and no-shop agreements. It explains the two guiding criteria, Competitive Neutrality and Non-coercion, that the Panel will apply when considering whether a lock-up device gives rise to unacceptable circumstances.

The term "lock-up device" refers to several types of arrangements entered into between bidders and targets (or other parties) to encourage or facilitate a takeover bid. The Panel does not consider lock-up devices to be prima facie unacceptable. However, the Panel is concerned to ensure that lock-up devices do not prevent control transactions from taking place in an efficient, competitive and informed market.

In relation to break fees, the Guidance Note explains the Panel's application of its "1% guideline" as a starting point for assessing whether a break fee is likely to be anti-competitive or coercive.

The Guidance Note should be read as applying to lock-up devices in other control transactions as well as takeover bids, such as schemes of arrangement and shareholder approved transactions, to the extent applicable.

Introduction

7.1 This Guidance Note[1] considers lock-up devices including break fees, asset lock-ups, no-talk agreements and no-shop agreements. As the principles discussed in it are of general application, they will be applied to any arrangement which has the effect of a lock-up device.

7.2 In this Guidance Note, the Takeovers Panel (**Panel**):

(a) states that it does not regard lock-up devices to be unacceptable as such; and

(b) sets out the criteria that it applies in assessing whether any particular lock-up device is unacceptable in relation to a takeover bid or other control transaction.

7.3 Whether circumstances are unacceptable depends on the effect or likely effect of the lock-up device on current and potential bidders, on shareholders and on the market, in light of the policy of sections 602 and 657A of the Corporations Act 2001 (the **Act**).[2] In particular that will depend on the principle of efficient, competitive and informed markets set out in paragraph 602(a).

7.4 The Panel examines on a case-by-case basis whether particular lock-up devices give rise to unacceptable circumstances, guided by the criteria set out in this Guidance Note. It considers that normally a lock-up device gives rise to unacceptable circumstances if it prevents the acquisition of control of a target taking place in an efficient, competitive and informed market. In particular, the Panel focuses on the competitive element: the device must not have a significant anti-competitive effect on existing or potential rival bidders, and on the efficient element: the device must not have a significant coercive effect on target shareholders making them unlikely to consider other alternatives (including taking no action) on their merits.

7.5 To avoid putting pressure on shareholders to accept a bid or locking out a potential competitor, the Panel considers that a break fee should not in general exceed 1% of the equity value of the target company. Size alone is not determinative, and other terms may render an agreement coercive or anti-competitive. A break fee which is more than 1% will be examined closely by the Panel to ensure that it is not anti-competitive or coercive. If the fee is 1% or less, the fee will generally not be considered unacceptable unless it is shown that the fee is coercive or anti-competitive.

7.6 Since the first issue of this Guidance Note in 2001, lock-up devices have been considered by the Panel in several matters that have come before it.[3] Those matters indicate that lock-up devices have continued to evolve in Australia. The Panel expects that it will need to continue to monitor the evolution of, and

[1] The Panel's Guidance Note will guide the Panel's administrative decision-making when implementing the legislation and legislative policy.
[2] All statutory references are to the Act, unless otherwise indicated.
[3] *Normandy Mining Limited (No. 3)* [2001] ATP 30, 20 ACLC 471; *Ballarat Goldfields NL* [2002] ATP 7, 41 ACSR 691; *Ausdoc Group Limited* [2002] ATP 9, 42 ACSR 629; *National Can Industries Limited* [2003] ATP 35, 48 ACSR 409; and *National Can Industries Limited 01R* [2003] ATP 40, 48 ACSR 427.

its own experiences with, lock-up devices, and to update this Guidance Note from time to time to keep it relevant.

7.7 This Guidance Note is not a statement of the law. The fact that a Panel does not declare an agreement to be unacceptable does not affect its legality or enforceability under other laws.

General Approach

7.8 The Panel is primarily concerned with whether the effect of any particular lockup device is contrary to the policy in paragraph 602(a) that control transactions take place in an efficient, competitive and informed market. If it secures an opportunity or proposal for sellers/shareholders to consider, a properly structured lock-up device may enhance the competitive environment.

Criteria

7.9 Two criteria that the Panel will apply when determining whether a particular lock-up device is contrary to the policy in paragraph 602(a) are:

(a) the device must not have a substantial anti-competitive effect; that is, it must not have a significant deterrent impact on the competition for control or on current or potential counter-proposals (**Competitive Neutrality**) – if the device does not achieve Competitive Neutrality, it is **Anti-competitive**; and

(b) the device must not have a substantial coercive effect on target shareholders when they are assessing that proposal or any current or potential counter-proposals (**Non-coercion**) – if the device does not achieve Non-coercion, it is **Coercive**.

7.10 These two criteria look at the effect of a particular device on two different classes of people. Competitive Neutrality focuses on the effect or likely effect of the lock-up device on current or potential buyers/bidders, while Non-coercion focuses on the effect or likely effect of the device on the sellers/shareholders. This dual focus is appropriate because competition in a market depends upon the existence of willing buyers and willing sellers of the relevant assets.

7.11 A device which has the effect or likely effect of impeding the willingness of current or potential buyers/bidders to advance their proposal or the ability of sellers/shareholders to consider and accept or respond to current or potential alternative proposals has the effect of undermining the competitiveness and efficiency of the market for control of the relevant company and generally. This is true, even if the device affects only one of those classes of people.

First movers and subsequent movers

7.12 The principles in this Guidance Note apply equally to lock-up devices agreed with a first bidder and to those agreed with subsequent bidders. In relation to break fees, a fee paid to a first bidder may induce it to make a takeover bid or initiate another proposal that it would not otherwise have made, potentially

starting an auction. A fee to a subsequent bidder is akin to an inducement for a person to enter an auction. In either case, a fee which is excessive in amount or badly structured may impede or even terminate the auction process in which case it may be considered unacceptable.

Lock-up devices in the context of other control transactions

7.13 As an alternative (or in addition) to a takeover bid, a person may seek to gain or increase control over a target company by other means: examples include schemes of arrangement (aspects of which are within the Panel's jurisdiction, subject to the Court's supervisory role), asset or business acquisitions and transactions requiring shareholder approval under item 7 of section 611.

7.14 Such a person (for the purpose of this Guidance Note referred to as the **bidder**) may seek to enter into the various types of lock-up devices mentioned in this Note for many of the same reasons as they would for a takeover bid. When considering such agreements, the Panel will refer to the policies set out in this Guidance Note, to the extent that they are applicable, in determining whether or not that agreement is unacceptable.

Break Fees

7.15 A break fee is most commonly an arrangement entered into between a bidder or potential bidder and the target of a proposed takeover bid or merger. Some form of consideration will be payable by the target if certain specified events occur which have the effect of preventing the bid from proceeding or causing it to fail (**triggers**). These events will typically be outside the control of the bidder (but not necessarily of the target or its shareholders) and the break fee might in many cases be viewed as an option fee paid to secure the opportunity for the target or its shareholders to consider. Therefore the Panel does not believe that payment of a break fee is of itself unacceptable in circumstances where, for example, shareholders reject the takeover bid or other relevant transaction.

7.16 A break fee can also be agreed by a bidder (e.g. where a bidder may be willing to pay a break fee in return for a period of exclusive negotiations or a due diligence opportunity).

The 1% guideline

7.17 It is good practice for anyone who agrees to pay a break fee to negotiate a fixed or capped figure, whether dollar or percentage based. In this regard, the Panel will use a guideline that a fee should not exceed 1% of the equity value of the target. For this purpose, the equity value is the aggregate of the value of all classes of equity securities issued by the target, where relevant having regard to the value of the consideration under the bid, as at the date the bid is announced.

7.18 As indicated in *National Can Industries 01(R)*,[4] the Panel starts from the position that a break fee which does not exceed the 1% guideline is unlikely to be either Anti-competitive or Coercive. Accordingly, to find that a break fee

[4] [2003] ATP 40 at [33].

which is within the 1% guideline is unacceptable the Panel will need to be satisfied that the fee arrangement is actually Anti-competitive or Coercive, because of its amount, structure, or effect.

7.19 Conversely, if the amount of a break fee is more than the 1% guideline, in order to find that the break fee is not unacceptable the Panel must be satisfied that the arrangement is neither Anti-competitive nor Coercive. Competitive Neutrality may be established by showing, for example:

(a) the fee is demonstrably not Anti-competitive because, for example, another current bidder has increased its bid, or a new bid has been proposed, since the break fee was announced;

(b) although the fee exceeds the 1% guideline, it was agreed only after a public and transparent process or auction conducted by the target or a controlling shareholder had occurred to elicit transaction proposals; i.e. the control proposal can be seen as the culmination of a suitable competitive process rather than as preventing it; or

(c) the bidder has incurred disproportionate cost, effort or risk in mounting its bid.

In addition, that party must demonstrate to the Panel that there are no other circumstances arising from the arrangement which might be Coercive.

7.20 In some limited cases, the Panel accepts that it may be appropriate for the 1% guideline to apply to a company's enterprise value rather than equity value, because for instance, the target is highly geared. In such a case, as with every fee in excess of 1% of equity value, a party seeking to justify the fee must be prepared to show that the fee does not have an Anti-competitive or Coercive effect.

Examples

1. *Normandy Mining Limited (No. 3)* [2001] ATP 30 – a break fee of approximately 1% of equity value, which might have been regarded as excessive because of the large size of the bid, was not unacceptable because a counter-bidder had over-bid the bid supported by the break fee.

2. *Ausdoc Group Ltd* [2002] ATP 9 - a break fee of 1.87% of equity value was not regarded as being unacceptable because of the previous public tender process, the high cost of preparing and carrying out the bid because of the complexity of the target's businesses and because the premium being offered to shareholders was many times the amount of the break fee.

Parties' costs

7.21 The costs (including both funded costs and opportunity costs) incurred by the parties to a proposal, though potentially relevant to their agreement on a break fee, are not of primary importance to the Panel in assessing whether the break fee is unacceptable. However, such costs may be taken into account; for example, as noted in 7.19 above.

Multiple Fees

7.22 Where there are multiple fee arrangements with the same party and its associates (in respect of the same, or related, transactions) the Panel may aggregate them for the purposes of the 1% guideline.[5]

Coercive effect and triggers

7.23 Whether a lock-up device is Coercive depends on its tendency to affect adversely the value or nature of shareholders' investment (via their shares) in the target company if they do not accept the relevant bid, or a competing proposal. A Coercive lock-up device can in fact be very similar to frustrating action[6], in nature and adverse effect. In both cases, the directors of a company enter into agreements that block or restrict the ability of target shareholders to determine the outcome of proposed control transactions.

Examples

1. *Ausdoc Group Limited* [2002] ATP 9 at [44] – a fee which was likely to absorb a very large proportion of the anticipated profits of a target, which was principally traded on the basis of its earnings and not on the value (or future value) of its assets, was considered Coercive.

2. *Ballarat Goldfields NL* [2001] ATP 7 at [14]-[16] – a fee which was to be "paid" by the issue of shares representing a 10% interest in the target was considered Coercive.

7.24 Triggers can have a Coercive effect on sellers/shareholders because they affect the circumstances in which the break fee is payable. However, when payment of the fee is triggered because of a more attractive counter-bid, there is unlikely to be any Coercive effect on sellers/shareholders as the success of the competing proposal has commercially supplanted the proposal which had been supported by the break fee agreement.

Carve-outs in break fee agreements

7.25 In general, the Panel does not accept that target board directors should require a break fee to be subject to the possibility of target directors changing their minds as to the desirability of the transaction to which the break fee relates as circumstances unfold. Such an agreement would be so uncertain for the bidder as to be hardly worth having. Target directors cannot foresee all future circumstances. They must make decisions on the basis of the information before them, reasonable enquiry, and a belief that the decision they make is, as far as they can tell, in the best interests of the company. [7]

7.26 However, each trigger needs to be appropriate to the stage that the negotiation or transaction has reached at the time that the board agrees to the break fee and its terms. If a step which is beyond the control of target directors but which critically affects the ability of those target directors to enter into a proposal is outstanding, those directors should consider whether it is appropriate to delay entry into the break fee arrangement until that step has

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[5] As was done with the first and second fees in *National Can Industries 01 and 01R* [2003] ATP 35 and 40. Contrast *Ausdoc Group Limited* [2002] ATP 9 at [38] where certain other fees were not aggregated with a break fee, because they were not in the nature of break fees.

[6] See Guidance Note 12: *Frustrating Action*, particularly at [12.18].

[7] *Normandy Mining Limited 03* [2001] ATP 30 at [40].

been taken or consider making the payment of the break fee contingent upon completion of that step.

Example

1. *National Can Industries Limited 01(R)* [2003] ATP 40 – one of the triggers in a break fee arrangement was for any director to withdraw their recommendation of the proposal. However, the directors had not yet obtained a required report from an independent expert, the support of which was critical to those directors being able to maintain their recommendation. Either the agreement should not have been executed until the report was obtained or there should have been a fiduciary exception where a director was obliged by their duties to reconsider their recommendation as a result of the receipt of the expert's report.

No-Talk Agreements

7.27 A no-talk agreement is an arrangement entered into between a bidder, or potential bidder, and the target by which a target agrees not to negotiate with any bidder or potential bidder, even if that bidder's approach to the target is unsolicited.

7.28 What is an acceptable no-talk agreement if the target has already conducted an effective auction process may not be acceptable if the target has not conducted an effective auction process before agreeing to the arrangement.

Safeguards

7.29 No-talk agreements are inherently more anti-competitive than, for example, no-shop agreements. Therefore, the safeguards required are more stringent, and the benefits that the agreement brings to target shareholders need to be greater and/or more certain. Target directors need to be convinced of the proper commercial and competitive benefits to their shareholders before agreeing to this form of agreement. The period of restraint must be limited and reasonable: in order not to be unacceptable, a no-talk obligation should usually cease once a public announcement of the relevant bid or proposal has been made.[8]

Fiduciary exception in no-talk agreements

7.30 The Panel regards it as essential that a no-talk agreement contain an appropriate 'fiduciary exception', allowing directors to respond positively to any better proposal if they form the view that to do so would be in the best interests of target shareholders.

7.31 All features of a no-talk agreement need to be considered in determining the likely effect on competition and on shareholders. For example:

(a) a 'fiduciary exception' might only allow directors of the target to consider an alternative proposal if they receive advice from a third party that it is a superior proposal or if they receive expert advice that they are obliged to consider the alternative proposal;

(b) an ancillary provision of the agreement might oblige the target to provide details of any approaches regarding alternative proposals to

[8] Compare the restraint on disposing of shares in *PowerTel Limited 01* [2003] ATP 25.

the original bidder or restrict the target in communicating relevant information to a potential rival bidder.

7.32 While it may be appropriate for the bidder to request features to be included in the carve-out requirements to ensure the no-talk agreement achieves its commercial objectives, these features should not be excessively restrictive.

No-Shop Agreements

7.33 A no-shop agreement is an arrangement entered into between a bidder, or potential bidder, and the target by which a target agrees not to solicit a takeover bid or other control transaction from a third party, usually during some defined period of exclusivity.

7.34 The Panel generally does not require that a no-shop agreement be constrained by a fiduciary exception, because it considers that a no-shop agreement is materially less Anti-competitive than a no-talk agreement: a no-talk agreement may diminish competition in the market for target shares by preventing an interested party from bidding, whereas a no-shop agreement only prevents the target from soliciting additional bidders or alternative transactions.

7.35 As with a no-talk agreement, the period of restraint under a no-shop agreement must be limited and reasonable. However, a no-shop obligation may extend into the bid period where this is justifiable having regard to the advantages that the agreement offers to target shareholders.

7.36 As with a no-talk agreement, ancillary provisions of a no-shop agreement may also be taken into account in determining whether it is Anti-competitive; if, for example, they oblige the target to provide details of any alternative proposals to the original bidder or restrict the target in communicating relevant information to a potential rival for control.

Asset lock-ups

7.37 An asset lock-up is an arrangement which may be entered into between a potential acquirer, and the target,[9] for example, agreements:

(a) by the target to sell a particular asset or assets in exchange for an agreement by the acquirer to make a bid or enter into another control transaction; or

(b) by the acquirer to buy a particular asset or assets in exchange for a defined period of exclusivity or the opportunity to undertake due diligence for a control transaction.

7.38 There has been little experience of asset lock-ups in Australia. If an asset lock-up involves an agreement to sell an important asset of the target (often the target's "crown jewels"), it can have the effect of making the target a less attractive acquisition candidate, and a less attractive investment for its

[9] The Panel recognises that companies may enter bona fide asset lock-up agreements well prior to, and outside the context of, a takeover bid. This Note applies only to asset lock-ups entered into in the context of an existing or proposed takeover bid.

shareholders. Accordingly, an asset lock-up may be both Anti-competitive and Coercive.

7.39 If an asset lock-up were entered into with a potential rival bidder (or as part of some other transaction) after the target company had received notice of a takeover bid or proposed takeover bid, the asset lock-up may also constitute "frustrating action" requiring scrutiny under the principles set out in Guidance Note 12: "Frustrating Action".

7.40 Even if a proposed asset lock-up would not directly eliminate meaningful competitive bidding for the target, the lock-up may nevertheless still be unacceptable if certain safeguards are not observed. In particular, the agreement should be negotiated on an arms length basis, should be at a fair price and should not adversely affect the amount or distribution of benefits accruing to shareholders in the target in connection with the takeover.

7.41 In the absence of an appropriate commercial reason for giving such an asset lock-up, the agreement may give rise to unacceptable circumstances. In general, asset lock-up devices are likely to be exposed to more scrutiny, and run more risk of being unacceptable, as the size or strategic value of the asset increases.

7.42 The Panel considers that it is good practice for a target board to seek expert advice on the appropriateness of any fixed price, or price formula, asset lock-up agreement.

Lock-up devices with major shareholders

7.43 In addition (or as an alternative) to the target company, a bidder may seek to enter into the various types of lock-up devices mentioned in this Note with a major shareholder of the target. When considering such an agreement, the Panel will refer to the policies set out in this Note, to the extent that they are applicable, in determining whether or not that agreement is unacceptable.

7.44 A lock-up device agreed with a major shareholder of a target as part of an arrangement for that shareholder to sell all or part of its holding to the bidder, by accepting the bid or otherwise, will affect competition for control of the target.

7.45 The Panel expects that the principal concern regarding such an arrangement will be whether it defeats the purpose of section 606 by allowing the bidder effectively to control the disposal of shares above the 20% threshold in circumstances other than those contemplated by the exceptions listed in section 611.

7.46 In general, the Non-coercion criterion does not apply to a lock-up device agreed with a major shareholder. However, the Panel will assess whether any such lock-up device satisfies the Competitive Neutrality criterion, such as in circumstances where the shares which are the subject of the lock-up device, when combined with any shares in the target then held by the bidder, exceed the 20% threshold – irrespective of whether or not the arrangement in question technically gives rise to a relevant interest.

Example

1. *Alpha Healthcare Limited* [2001] ATP 13 at [23]-[24] – a mere commercial commitment by a seller/shareholder with economic incentives was not regarded as leading to a contravention of section 606 where it was clear that the seller/shareholder was free to accept a competing bid.

Disclosure

7.47 The existence and nature of any lock-up device should normally be announced together with the relevant proposal, when the proposal is required to be announced under the continuous disclosure provisions which apply to each of the parties.[10] This announcement should:

(a) be made in a way that will bring the information to the attention of shareholders generally – so if the bidder or the target is listed, to the relevant home exchange (and if both are listed, to both of them); and

(b) include all the relevant terms of the arrangements – even if they are embodied in separate documents.[11]

7.48 There may be circumstances where the nature and existence of the lock-up device itself are sufficiently material to require its disclosure under the ASX Listing Rules forthwith, without waiting until the related proposal itself has reached the point of requiring disclosure.[12]

7.49 The bidder's statement and target's statement (or any other relevant document, such as an explanatory statement for a scheme of arrangement) should fully disclose the terms of the lock-up device again.

Process

7.50 Where a break fee or other lock-up device comes before the Panel, directors are expected to be able to explain their decision making process in considering the relevant issues relating to lock-up devices (including any advice taken) and the appropriateness of entering the arrangements.

Remedies

7.51 The Panel has a wide power to make orders (including remedial orders) if it finds that a lock-up device gives rise to unacceptable circumstances. For example, the Panel may cancel or declare voidable an agreement (i.e. the lock-up device or any other agreement) relating to a takeover bid, or a proposed takeover bid, or any other agreement in connection with the acquisition of securities. It can also make orders or accept undertakings that have the effect of removing any anti-competitive or coercive effect.

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[10] Such as Listing Rule 3.1 or section 675 of the Act. Confidentiality provisions in a lockup agreement can satisfy LR 3.1A.1 or regulation 6CA.1.01(b), but can only be observed while the other requirements of LR 3.1A or regulation 6CA.1.01 are satisfied.

[11] *Normandy Mining Limited (No. 3)* [2001] ATP 30 at [39].

[12] In *AMP Shopping Centre Trust 01* [2003] ATP 21, the Panel made a declaration of unacceptable circumstances in relation to contractual pre-emptive rights over the assets of a target, the existence of which rights had not been fully disclosed to the market until a bid was made for the company.

Examples

1. *Ballarat Goldfields NL* [2002] ATP 7 – the Panel ordered that the shares which were to constitute the break fee not be issued and no other benefit be provided in substitution.

2. *Ausdoc Group Limited* [2002] ATP 9 – the Panel accepted undertakings from the fee-taker to waive its right to receive and not to accept the payment of a particular fee and from the fee-payer not to pay that fee.

3. *National Can Industries Limited 01(R)* [2003] ATP 40 – the Panel accepted undertakings from the fee-taker to increase the consideration to be provided by it to shareholders under the relevant scheme of arrangement by an amount equal to the per share value of the break fee, to repay the break fee in certain circumstances and not enforce or accept payment of a second break fee and from the fee-payer not to pay that second break fee.

Legality

7.52 Regardless of whether or not a particular lock-up device is unacceptable under the approach set out in this Guidance Note, other laws may make that lock-up device void or unenforceable. For example, it may be void or unenforceable because it contravenes the law relating to directors' duties, reductions of capital, or financial assistance.

7.53 While the Panel does not wish to facilitate lock-up devices which appear to be clearly invalid, directors are responsible for the legality and validity of agreements into which they enter. Therefore, before entering into a particular lock-up device, directors must consider their fiduciary duties and statutory obligations and consider seeking expert legal advice.

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