Australian Government
Takeovers Panel

REWRITE OF GN 7, GN 12, GN 14 AND GN 17

PUBLIC CONSULTATION RESPONSE STATEMENT
11 FEBRUARY 2010

Introduction

On 13 May 2009, the Takeovers Panel released a Consultation Paper seeking public comment on the following rewrites of its guidance notes:

- GN 7 (Lock-up devices)
- GN 12 (Frustrating action)
- GN 14 (Funding arrangements)
- GN 17 (Rights issues)

Comments on the Consultation Paper were due by 30 June 2009 and the Panel received five submissions in response. The Panel thanks those who made submissions for their comprehensive comments. Consistent with the Panel's published policy on responding to submissions, this paper sets out the Panel's response to the public consultation process and its conclusions on the main comments received from respondents.

Some responses made a number of editorial comments, many of which have been incorporated into the final guidance notes. Attached to this paper are copies of the final guidance notes, in mark up to show the changes from the drafts circulated with the Consultation Paper.

Material comments received and Panel's conclusions

GUIDANCE NOTE 7: LOCK-UP DEVICES

Scope of the guidance note

Comment

Two respondents suggested that the guidance note apply to schemes as well as bids.

Response

The guidance note is now said to apply to "*control transactions, including takeovers*" (paragraph 1).

Break fees – 1% guideline

Comment

Paragraph 11 of the redraft to GN 7 stated that the Panel, in considering whether a break fee gives rise to unacceptable circumstances, would be guided by, among other factors, "*whether the fee exceeds 1% of the equity value of the target*", and stated that in "*the absence of other factors, a 1% fee is generally not unacceptable*". Three respondents submitted that more guidance should be given on what the Panel will take into account in determining whether a break fee is unacceptable and make it clearer that break fees under 1% will be prima facie not unacceptable. One respondent submitted that it should be made clear that a break fee of less than 1% may in some circumstances still be unacceptable.

Response

GN 7 has been rewritten to:

- clarify that in the "*absence of other factors, a break fee not exceeding 1% of the equity value of the target is generally not unacceptable*"
- state that there may be facts which make a fee within the 1% guidance unacceptable, for example if the triggers to the fee are unacceptable and
- make explicit the need for the triggers for payment of the fee to be reasonable.

"Naked no vote" break fees

Comment

One submission suggested that the guidance note should address the circumstances in which "*naked no vote*" break fees (triggered if the takeover is rejected by target shareholders) are unacceptable. Another submission suggested that "*such fees should be against Panel policy unless for a negligible amount (considerably less than 1% of market value) and then only to reimburse the bidder's actual transaction costs*".

Response

The existing guidance note states in paragraph 7.16 that the "*Panel does not believe that payment of a break fee is of itself unacceptable because it becomes payable upon shareholders rejecting the takeover bid or other transaction*" but refers to another section of the guidance note which discusses the possible coercive effect of a lock-up device (paragraph 7.24). When the Panel last reviewed the guidance note, it stated that "*it can be appropriate for a break fee to be paid on rejection by shareholders of a transaction. Of*

course, the Panel will still consider all of the particular circumstances of any such break fee in deciding whether or not it is unduly coercive".[1]

The Panel has decided to make it clearer that a "naked no vote" break fee may be an unreasonable trigger, depending on the circumstances, even if within the 1% guideline (see footnote 9 to paragraph 9).

Notification obligations and matching rights

Comment

One respondent suggested separating the discussion regarding notification obligations and matching rights from the discussion relating to no-shops, no due diligence and no-talk restrictions. Another respondent suggested that there should be a separate discussion of notification obligations.

Response

The section in the guidance note on restriction agreements has been rewritten to reflect that different types of restrictions and safeguards can be brought together in combination, which can change the overall impact of the agreement. There is also a separate discussion in relation to notification obligations and matching rights (see paragraphs 15 and 16).

GUIDANCE NOTE 12: FRUSTRATING ACTION

Triggering actions

Comment

One respondent submitted that the definition of a frustrating action should include reference to "*an essential characteristic of a defeating action, which is that it triggers a defeating condition, leading to failure of the relevant bid*". Another respondent submitted that a frustrating action should be limited to breaches of bid conditions, while acknowledging that the existing guidance note is also "*unclear on this point*".

Response

The Panel considers that it was unnecessary to continue to have the separate concept of "*triggering action*". Therefore the guidance note has been simplified by wrapping up the concept of "*triggering action*" into the definition of "*frustrating action*". Most but not all frustrating actions are likely to consist of a breach of a condition to a bid or an announcement. Therefore the Panel has not adopted the suggestion.

[1] Panel Releases Revised Guidance Note 7 – Lock-Up Devices, TP 05/20

Shareholder approval of frustrating action

Comment

Example 1 of paragraph 14 of the draft guidance note stated that a target may be able to obtain shareholder approval of a frustrating action by directors *"announcing that they will enter into an agreement after a specified, reasonable time, unless control has by then passed to the bidder"*. One respondent submitted that this approval method should *"only be available after allowing a reasonable time for control to pass, after the bid has become unconditional"*. Another respondent suggested that a reasonable time could commence *"once a bid is unconditional or subject only to a minimum acceptance condition and/or no prescribed occurrences"*.

Response

The Panel has included a footnote to example 1 of paragraph 14 that:

> *"Reasonable time may be affected by the length of the bid period or the status of any bid conditions."*

Directors' duties

Comment

One respondent submitted that paragraph 11 of the draft guidance note implies that the Panel may decline to conduct proceedings if a frustrating action may also constitute a breach of directors' duties. Another respondent expressed the concern that the draft guidance note did not make it clear a frustrating action may be unacceptable even if it is consistent with directors' duties.

Response

The Panel has deleted paragraph 11 and made it clear in paragraph 10 that undertaking *"a frustrating action may give rise to unacceptable circumstances regardless of whether it is consistent with, or a breach of, directors' duties"*.

Bids conditional on target board recommendation

Comment

One respondent suggested that if a potential bidder states to the target that it will only make a bid if it can obtain the target board's recommendation and the target board refuses to recommend, then it is the target board's refusal that frustrates the bid rather than a subsequent action that may trigger a condition to the proposed bid. Therefore in this case, the circumstances might not be unacceptable.

Response

The Panel has included a footnote to paragraph 7 that states that an *"action that triggers a 'condition' in a potential bid may not give rise to unacceptable circumstances if the bidder indicted that it would proceed only if the bid was recommended and the directors have rejected the approach"*.

GUIDANCE NOTE 14: FUNDING ARRANGEMENTS

Failure to pay accepting shareholders

Comment

Paragraph 9 of the consultation paper stated that:

> *Usually, the terms of an off-market bid allow for the transfer of accepted shares before payment. This could result in accepting shareholders becoming unsecured creditors of the bidder. The issue is addressed in paragraph 10(f) of GN 14, but this is untested and could be ineffective if liquidation laws prevail. To remove that risk, should a requirement for payment no later than transfer be introduced (eg, a bid condition to that effect)? If so,*
>
> *9.1. should the law be amended or should the 'requirement' be included in guidance (ie, in terms of unacceptable circumstances)?*
>
> *9.2. what practical issues should be taken into account?*
>
> *9.3. are there related issues that should be addressed?*

Responses varied along the following lines:

(a) No change is necessary. The Panel has the power to make orders reversing any transfers of shares not paid for.

(b) There should be a requirement (either in the guidance note, or preferably by way of legislative change) to incorporate an escrow structure *"in the takeover process such that the transfer of legal ownership of shares accepted into a takeover offer occurs simultaneously with dispatch of payment"*. If this recommendation was adopted, the maximum time between acceptance of a takeover offer and payment could be reduced from one month to seven days.

(c) State that unacceptable circumstances are likely to occur if title to bid class securities passes prior to payment of consideration or if 'Quistclose trust' arrangements are not adopted for the payment of bid consideration (two respondents).

(d) Bidders should be required to make arrangements which will ensure that the bidder does not obtain beneficial title (and perhaps legal title) to shares for which acceptances are received unless and until they are paid for. If the Panel considers that its power to make declarations and orders is insufficient, it could make a rule under s658C or ask ASIC to make a class order.

Response

The Panel has decided to continue with its existing guidance on this issue (that not paying accepting shareholders risks a declaration of unacceptable circumstances) but has added a statement that a bid can contain the term that an *"accepting shareholder retains an equitable interest in the shares until paid"*.

Bid and financing conditions

Comment

Paragraph 10 of the consultation paper asked whether bids "*that are conditional on finance be required to include a condition that precisely matches the financing conditions of the financier*"? Three respondents were not in favour of this proposal. The main reason cited was that an exact matching of conditions was not practicable. One respondent suggested that it would preferable to require bids to be subject to a defeating condition, "*which cannot be satisfied or waived until the bid financing is unconditional*".

Response

The Panel has decided not to require a matching of financing and bid conditions.

Disclosure of alternative sources of funds

Comment

The draft guidance note stated (in paragraph 6) that if there are alternative sources of funding, "*each must be in place or provide a reasonable basis for the bidder to expect that it will be in place*". Two respondents suggested that this requirement should only apply for sources of funding that have been disclosed.

Response

The Panel has accepted this suggestion and has amended paragraph 6 accordingly.

Exchange rates

Comment

Two respondents submitted that in certain circumstances, a bidder may need to provide further disclosure regarding exchange rate risk.

Response

The Panel has inserted a new paragraph 24 which states that where bid consideration comprises foreign currency, "*additional disclosure regarding any exchange rate risks and their management may also be needed*".

Accountant's certificate

Comment

The draft guidance note suggests that, when funding of a bid is not from a financial institution, a bidder should disclose the funder's accounts or an accountant's certificate as to the funder's ability to meet its obligation. One respondent submitted that it was important that there be sufficient disclosure of the accountant's certificate in the bidder's statement for target shareholders to be able to assess whether the funder can meet its obligation.

Response

The Panel has included in paragraph 22(a) a statement that disclosure of an accountant's certificate should include *"disclosure of the content of the accountant's certificate or enough of it to allow shareholders to be satisfied of the sufficiency of the arrangements"*.

GUIDANCE NOTE 17: RIGHTS ISSUES

More guidance required

Comment

One respondent submitted that the draft guidance note provided less guidance than the current guidance note. Another respondent considered that, like the current guidance note, the draft guidance note lists the factors that the Panel will take into account but does not provide sufficient guidance on *"the likely effect of those factors"*.

Response

The Panel has amended the guidance note to provide more guidance, including references to recent decisions (see changes to paragraphs 5, 6, 7, 8, 10 and 18). In particular it has been clarified that the Panel looks at the effect of the rights issue beyond what is reasonably necessary for fundraising.

Attached

Marked up copies, showing changes from consultation version of the GNs to final version, of:

- GN 7 (Lock-up devices)
- GN 12 (Frustrating action)
- GN 14 (Funding arrangements)
- GN 17 (Rights issues)