

GUIDANCE NOTE 1: UNACCEPTABLE CIRCUMSTANCES

Overview

This policy discusses when the Takeovers Panel (*Panel*) may make a declaration of unacceptable circumstances under s657A of the Corporations Act 2001 (the *Act*) and the matters which the Panel will take into account in making such a declaration. In particular it provides guidance on the circumstances the Panel may consider unacceptable.

The Panel aims to correct unacceptable circumstances as quickly and cost effectively as possible, and ensure that the outcome of takeover proposals are decided by informed shareholders who have confidence in the integrity of Australia's market for corporate control.

Power to declare unacceptable circumstances

1.1 Section 657A provides that

- “(1) The Panel may declare circumstances in relation to the affairs of a company to be unacceptable circumstances. Without limiting this, the Panel may declare circumstances to be unacceptable circumstances whether or not the circumstances constitute a contravention of a provision of this Act.*
- (2) The Panel may only declare circumstances to be unacceptable circumstances if it appears to the Panel that the circumstances:*
- (a) are unacceptable having regard to the effect of the circumstances on:*
 - (i) the control, or potential control, of the company or another company; or*
 - (ii) the acquisition, or proposed acquisition, by a person of a substantial interest in the company or another company; or*
 - (b) are unacceptable because they constitute, or give rise to, a contravention of this Chapter or of Chapter 6A, 6B or 6C.*

The Panel may only make a declaration under this subsection, or decline to make a declaration under this subsection, if it considers that doing so is not against the public interest after taking into account any policy consideration that the Panel considers relevant.

- (3) In exercising its powers under this section, the Panel:*
- (a) must have regard to:*
 - (i) the purposes of this Chapter set out in section 602; and*
 - (ii) the other provisions of this Chapter; and*
 - (iii) the rules made under section 658C; and*
 - (iv) the matters specified in regulations made for the purposes of paragraph 195(3)(c) of the Australian Securities and Investments Commission Act 1989; and*
 - (b) may have regard to any other matters it considers relevant.*

In having regard to the purpose set out in paragraph 602(1)(c) in relation to an acquisition, or proposed acquisition, of a substantial interest in a company, body or scheme, the Panel must take into account the actions of the directors of the company or body or the responsible entity for a scheme (including actions that caused the acquisition or proposed acquisition not to proceed or contributed to it not proceeding).”

Objectives of Chapter 6

1.2 Section 602 of the Act provides that

“The purposes of this Chapter are to ensure that:

- (a) the acquisition of control over:
 - (i) the voting shares in a listed company, or an unlisted company with more than 50 members; or*
 - (ii) the voting shares in a listed body; or*
 - (iii) the voting interests in a listed managed investment scheme,*takes place in an efficient, competitive and informed market; and*
- (b) the holders of the shares or interests, and the directors of the company or body or the responsible entity for the scheme:
 - (i) know the identity of any person who proposes to acquire a substantial interest in the company, body or scheme; and*
 - (ii) have a reasonable time to consider the proposal; and*
 - (iii) are given enough information to enable them to assess the merits of the proposal; and**
- (c) as far as practicable, the holders of the relevant class of voting shares or interests 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, body or scheme; and*
- (d) an appropriate procedure is followed as a preliminary to compulsory acquisition of voting shares or interests or any other kind of securities under Part 6A.1”.*

What constitutes unacceptable circumstances?

- 1.3 Before amendments made to the Act in 1994, the Panel was confined to declaring that certain *conduct* or a particular *acquisition* was unacceptable, if one of the Eggleston principles (now set out in paragraphs 602(b) and (c)) was not satisfied. It was in effect an anti-avoidance power. The Panel’s declaration power is now much wider.
- 1.4 There is no definition of unacceptable circumstances in the Act. Instead, the Panel is directed to use s602 and Chapter 6 of the Act as reference points to determine when circumstances are unacceptable. The legislature considered that black letter law would be insufficient to define all the possible circumstances that might defeat the policy of s602. Accordingly, it empowered the Panel, as an expert body, to address new issues by declaring circumstances unacceptable.
- 1.5 Whether circumstances are unacceptable depends on their effect on persons affected by transactions which influence control and on the market, in the light of the policy of s602. It does not depend on the occurrence of unacceptable conduct or any intention to bring about an objectionable state

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of affairs. A state of affairs may be unacceptable due to inadvertence, and despite the best of intentions.

- 1.6 Conduct may give rise to unacceptable circumstances as well as breaching the Act. Not all unacceptable circumstances will constitute breaches of the Act, however, and if a breach does not give rise to a mischief of a kind relevant to s602, it may not lead to unacceptable circumstances.¹
- 1.7 In deciding what constitutes unacceptable circumstances, the Panel will be guided not only by the policy of Chapter 6 as set out in general terms in section 602, but also by the detailed implementation of that policy in the remainder of Chapter 6 and in Chapter 6A, 6B and 6C.
- 1.8 Although it is expected that takeover bids will account for the majority of matters before the Panel, section 657A applies to unacceptable circumstances in situations that do not involve bids. Examples are rights issues, buybacks and resolutions to approve acquisitions of shares and reductions of capital.

Types of unacceptable circumstances

- 1.9 The first broad category of unacceptable circumstances is where holders of voting shares or units do not have *reasonable* and *equal opportunities* to take part in *benefits* accruing to holders of shares or units in connection with a control transaction effecting control. *Reasonable* means that holders have adequate time to consider, sell, vote etc, and are not exposed to pressure tactics or maximum acceptance conditions (in bids) or uncommercial pricing.² *Equality* means equal value, not identical dealing. The *opportunity* is often to participate directly, by selling their shares or units, but it can also be an opportunity to participate indirectly, by voting on a transaction.³ The *benefits* can be given directly or in collateral transactions,⁴ and need not take the straightforward form of a price for shares.⁵
- 1.10 A second category of unacceptable circumstances is where, even if holders have opportunities to share in the benefits, they do not have the *information* necessary to make an informed decision or are misled about the relevant transaction. The decision could be whether to accept a bid or whether to

¹ For example, if a breach of the disclosure obligations in Chapter 6 is remedied by additional or clarificatory information which is included in a supplementary statement, it will cease to constitute unacceptable circumstances: see *Email Limited (No. 1)* (2000) paragraph 33. However, if an erroneous view would be propagated by certain information, and that view would be difficult to correct, then it may give rise to a mischief of a kind that constitutes unacceptable circumstances: see *Re Email Limited (No. 2)* (2000) paragraph 48.

² For example, unreal pricing may be a concern in a rights issue.

³ See, for example, item 7 of s611.

⁴ For instance the price of the other parcel of shares in *Magellan v Sagasco*.

⁵ For example in relation to the takeover bid by Pivot for Gibson's, shareholders of the target (Gibson's) were in the first instance denied a full price for their shares because the bidder (Pivot) obtained the transfer of a key supply arrangement from Gibson's to another subsidiary of Pivot. This deflated the Gibson's share price and so Pivot was able to make a significantly lower offer than it might otherwise have had to if Gibson's had retained the valuable supply contract.

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approve a transaction. Misinformation may be just as harmful as a shortage of information. A breach of a general disclosure provision⁶ will usually give rise to unacceptable circumstances. Material breach of a specific disclosure provision will also be generally unacceptable. Any failure to provide information reasonably expected by the market and relied on to make decisions about a bid, such as notices under the Listing Rules or section 643, 644, 630 or 671B⁷, may be unacceptable.

- 1.11 A third category of unacceptable circumstances is where an efficient, competitive and informed market in the relevant securities is inhibited.⁸ Such circumstances may result from market manipulation, a deficiency of information, or the premature lockout of rival bids. Anything which leads to a false market in any securities affected by a bid or transaction may be in this category. It will often, but not always, coincide with the second category.
- 1.12 A fourth category of unacceptable circumstances is where appropriate procedures are not followed leading up to compulsory acquisition of securities under Part 6A.1. Part 6A.1 relates to compulsory acquisition of bid class securities in the aftermath of a bid under Chapter 6.⁹ An example would be a bid which satisfied subsection 661A(1) only because of acquisitions which did not reflect an arms-length approval of the terms of the bid.

Contraventions of the Act

- 1.13 Unacceptable circumstances may arise from a contravention of a provision of the takeovers chapters. This need not involve a breach of the Chapter with criminal consequences, as a section is contravened if it is not complied with, even if the mental element of any offence is absent, or the person who committed the contravention has a defence.¹⁰
- 1.14 Not every contravention of every provision will give rise to unacceptable circumstances. It would be premature to catalogue contraventions which will (or will not) have that effect. However, any contravention of a provision mentioned in section 612 may well be unacceptable, because it tends to lead to an uninformed market or unequal access to the benefits offered under the bid. By analogy, so may a contravention of items 5, 11, 12, 13 or 14 of section 633 or of items 2, 5, 8, 10, 11, 12, 13 or 14 of section 635.

⁶ Such as paragraph 636(1)(g) or (m).

⁷ Supplementary bidder's statements, supplementary target's statements, notices regarding satisfaction of defeating conditions and substantial holders' notices.

⁸ Not wherever such a market is absent, since it is impossible to legislate for a liquid or competitive market. The aim here is to ensure that investors in takeovers are not misled and competition is not stifled.

⁹ It also relates to securities which are convertible into bid class securities, but the bidder cannot compulsorily acquire those under Part 6A.1.

¹⁰ In section 9, "'contravene' includes fail to comply with" a contravention may be constituted by the *actus reus* of an offence, whereas a breach would require the *mens rea* as well.

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- 1.15 A general disclosure provision such as paragraph 636(1)(g) or (m) requires a person to provide all of the information which bears on a decision and is available to (or known to) the bidder. A contravention of such a provision will generally be unacceptable, because it will lead to offerees being given less information than they reasonably require. A contravention of a provision which requires the provision of specified information will be unacceptable, if the information is material in the particular circumstances. Minor failures to comply with timing provisions may be unacceptable, particularly if other persons may change their positions in reliance on compliance with those provisions: examples are waiver of conditions and extensions of conditional bids (subsections 630(3), 650C(2) and 650F(1)).

Examples of other circumstances that may be unacceptable

- 1.16 The examples set out in the following paragraphs are drawn from policy published by the NCSC and ASIC. They are not an exhaustive list of the situations in which unacceptable circumstances may arise.

Withholding consent

- 1.17 Where a target seeks an extension of time in relation to the dispatch of its target's statement, ASIC will not grant such a modification if the target statement would be dispatched less than ten business days before the close of the offer period, unless the bidder agrees to extend the offer period under s649C. Obtaining the agreement of the bidder is the responsibility of the target. However, late dispatch of the target's statement without an extension of the bid may amount to unacceptable circumstances.

Public announcements

- 1.18 A bidder may bring about unacceptable circumstances if it makes a public announcement which is apt to affect decisions whether to accept the bid or deal in securities of the target, such as a statement that the bid price will not be increased, or that the period will not be extended, and later acts contrary to the statement. Even if a statement is expressly confined to present intentions, it may lead to unacceptable circumstances unless a fresh statement is made when the intentions change.

Actions of the target board

- 1.19 Section 657A(3) specifically enables the Panel to take into account the actions of the directors of a target company in considering whether to make a declaration of unacceptable circumstances.
- 1.20 Directors of a target must be careful to avoid actions which may constitute unacceptable circumstances, such as failing to recommend a bid to shareholders which it would clearly be in the best interests of shareholders to accept, employing excessive defensive tactics, or any other actions which would not be consistent with their directors' duties, particularly the duty to

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act in the best interests of the company. Directors must remember that it is for shareholders to decide whether or not control of the target should pass.

- 1.21 Directors of a target might also bring about unacceptable circumstances if, during the course of a bid, they allowed to happen one or more of the prescribed occurrences set out in s652C of the Act. These include a reduction in share capital, the issue of convertible notes, entry into management agreements and the disposal of the whole or a substantial part of the target's (or a subsidiary's) business or property. A market bid may be withdrawn if one of these events happens, and it is normal for off-market bids to be conditional on their not happening. However directors must still act in the best interests of the shareholders of the target company while a takeover bid is current.

Share buy-backs

- 1.22 If the terms of a share buy-back are unreasonable, it may lead to unacceptable circumstances. In determining whether a buy-back is unreasonable, the Panel will consider the effect on the control of the company, or another company, and the provisions of s602, in particular, whether the shareholders have been given sufficient information and afforded a reasonable and equal opportunity to participate in any benefits.

Warehousing

- 1.23 Circumstances in which a party possesses and uses "inside" information, may (leaving aside the issue of whether the use of that information amounts to a breach of the insider trading provisions) give rise to unacceptable circumstances.

Acquisition of securities in a target by an associate

- 1.24 Where securities in a target are acquired by an associate of the target or its directors as part of a defence to a takeover bid, and the associate subsequently obtains a benefit from the target company, such as an interest in the assets of the target or a material trading arrangement with the target, then it may be considered that unacceptable circumstances have arisen.

Acquisition of securities by an underwriter

- 1.25 In some instances where a company makes a substantial rights or convertible securities offering and the issue is underwritten and as a result of a shortfall, the underwriter (or sub-underwriter) may acquire a substantial interest that affects control of the company. These may be considered to be unacceptable circumstances. This will certainly be the case in circumstances where it appears that the outcome was intended and the rights issue and underwriting were an artifice to enable the result to be brought about.

- 1.26 Circumstances which may influence the Panel include:

(a) advice received from securities advisers;

- (b) attempts to find unrelated underwriters and sub-underwriters;
- (c) attractiveness of pricing;
- (d) market factors during the offer;
- (e) disclosure made or not made by the company before or during the offer; and
- (f) advice from external experts to the Panel.

1.27 It is, however, acknowledged that circumstances may sometimes be such that a company needs to raise capital and the most favourable means of doing so is through a rights issue, the success of which cannot be assured.

Approval by resolution of target shareholders

1.28 Item 7 of s611 permits an acquisition of shares in a company which has been approved by shareholders in that company, although it would otherwise contravene the prohibition set out in s606. Shareholders must be given certain information about the acquisition. Failure to provide that information may attract a declaration of unacceptable circumstances (as well as lead to a breach of the Act).

Provision of false or misleading information to target shareholders

1.29 Provision of false or misleading information to the market or to target shareholders during the course of a bid may lead to unacceptable circumstances. This includes indirect publication, such as where misinformation is provided to a securities analyst or financial journalist, who publishes it. The false or misleading information need not come from one of the participants in the takeover. A person who has access to reliable information may be required to correct rumours or other misinformation in the market, whether or not they bear any responsibility for the publication of that misinformation.

Statements about intentions

1.30 If a bidder has not made a decision regarding issues such as the future of the business and the employees of the target, or any changes to the target's business, and the bidder fails to disclose in its bidder's statement, pursuant to s636(1)(c) or (d), the possible courses of action it is considering in relation to such matters, then the Panel may consider that unacceptable circumstances have arisen.

How to make an application for a declaration of unacceptable circumstances

1.31 To apply to for a declaration of circumstances, you must lodge a written application with the Panel. The application must contain the information specified in the Panel Rules which can be accessed at www.takeovers.gov.au.

1.33 You can contact the Panel for information and assistance at:

Level 47, 80 Collins Street
Melbourne Victoria 3000
Ph: +61 3 9655 3500
Fax: +61 3 9655 3511

or at takeovers@takeovers.gov.au
or at the Panel's website at <http://www.takeovers.gov.au>

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Examples of circumstances that the Panel has said may be unacceptable

1. The Panel declined to make declarations of unacceptable circumstances in the two recent matters concerning bids for Infratil Australia Limited (*Infratil*) and Email Limited (*Email*). However, a number of useful statements were made by the Panel with respect to those applications.

Infratil application

2. The Infratil application concerned the bid made by Australian Infrastructure Fund Limited and Hastings Funds Management Limited, as responsible entity of the Australian Infrastructure Fund (collectively *AIF*) for all the shares in Infratil. Because AIF offered its own scrip as consideration, prospectus information about the proposed merged AIF/Infratil entity and information about the tax consequences of the takeover was relevant to an offeree's decision. Infratil sought a declaration that unacceptable circumstances existed because AIF's bidder's statement contained insufficient information about these matters and an order that the statement be amended by the inclusion of additional information.
3. The Panel was satisfied that the bidder's statement was defective in both respects and that the defects were material, but did not ultimately make the declaration because AIF offered to prepare and dispatch a supplementary bidder's statement containing sufficient additional information to remedy the Panel's initial concerns.¹¹

Email application

4. The Email application concerned the bid made by Smorgon Distribution Limited (*Smorgon*) for all the shares in Email. Smorgon offered \$1.85 and one Converting Appliance Preference share (*CAPs*) for each Email share held.¹² Email applied for a declaration of unacceptable circumstances and for interim and final orders. Email alleged, *inter alia*, that certain aspects of the structure of the bid did not comply with the Act and that the disclosure in the bidder's statement was inadequate and that it contained misleading statements.
5. The Panel found that the bidder's statement as lodged was "unmistakably and materially defective in compliance with section 710".¹³ The Panel noted that was unacceptable, both under paragraph 602(b)(iii) and because Smorgon did not comply with a general disclosure provision. However, Smorgon undertook to address these concerns by sending supplementary statements containing:

¹¹ See *Infratil Limited (No. 2)* (2000) paragraphs 19, 23 and 58.

¹² Smorgon's intention is to procure conversion of the CAPs into ordinary shares in a company holding the Email whitegoods business.

¹³ See *Email Limited (No. 3)* (2000) paragraph 115.

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- (a) an amendment to the terms of the CAPs clarifying the bidder's obligations in the event that it is unsuccessful in effecting either conversion or exchange of the CAPs into ordinary shares in a company holding Email's whitegoods business;
- (b) further discussion of some of the potential risks relating to the CAPs;
- (c) further information from SG Hambros concerning the most appropriate approach for valuing the CAPs; and
- (d) pro forma consolidated financial statements for the bidder (and its parent company) on the basis that the bidder acquires all of the ordinary shares in Email and on the basis that it acquires 50% of the ordinary shares in Email.

Accordingly, no declaration of unacceptable circumstances was made.