

GUIDANCE NOTE 12: FRUSTRATING ACTION

Summary

Although it is generally the responsibility of a company's directors to make company decisions, decisions about control and ownership of the company are properly made by its shareholders. Where a corporate action could frustrate a proposal concerning control or ownership of a company, the Panel will generally require that shareholders be able to determine the control and ownership of the company. The Panel expects that target company directors will act appropriately in such situations and that references to the Panel on these matters will not be common.

Action taken by a target company is likely to frustrate a takeover bid if taking that action has a material effect on the objective of the bid. Such action will usually allow the bidder either to rely upon a condition in its offer, causing the offer to lapse, or allow a bidder not to proceed with a genuine potential offer.

Not every action taken or proposed to be taken by target company directors which may frustrate an offer will give rise to unacceptable circumstances. Whether unacceptable circumstances exist will depend on the particular facts in each case.

Neither the Corporations Act nor the common law expressly prohibit a target company board from taking action that may frustrate a takeover offer. In some cases, target company directors' duties may indicate a path of action which could have the effect of frustrating a bid.

Frustrating action may give rise to unacceptable circumstances if the particular circumstances offend the principles set out in sections 602 and 657A of the Corporations Act, even if it is otherwise legal or required for the proper performance of the directors' duties. In such a case, the Panel may prevent the target from proceeding with the frustrating action, unless it has first been approved at a general meeting of target shareholders, or the target has taken some other action to avoid unacceptable circumstances arising.

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Introduction

1. In this Guidance Note¹, the Panel indicates the approach it will take when considering actions of the directors of a company which is subject to an offer or genuine potential offer (“*offer*”), where those actions may lead to the offer lapsing, being withdrawn or not proceeding. It does not comment on the legal validity or enforceability of particular actions.
2. A *potential offer* is an offer the terms of which have been communicated to target directors publicly or privately by a genuine bidder, but is not yet a formal offer under Chapter 6 of the Corporations Act.²
3. *Triggering action* is action taken by the target board that triggers a defeating condition of an offer (a precondition, in the case of a potential offer), such that:
 - (a) the bidder may allow its offer to lapse (or not make the offer);
 - (b) the bidder is permitted to withdraw its offer without ASIC approval³;
or
 - (c) ASIC might allow the bidder to withdraw its offer.⁴
4. In formulating its approach, the Panel has sought not to be prescriptive. Rather, it seeks to provide the market with guidance as to factors the Panel will consider when assessing whether triggering action gives rise to actual or potential unacceptable circumstances. The triggering action may be completed or proposed, and may be in the context of a particular offer or other transaction affecting control.
5. Whether circumstances are unacceptable depends on their effect on shareholders and on the market, in the light of the policy of sections 602 and 657A. It does not depend on any intention to bring about an objectionable state of affairs.

Legislative basis for policy

6. This Guidance Note concerns the principles set out in paragraphs 602(a) and 602(c) that:

“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*

¹ The issues relating to Frustrating Action may overlap with those of Lock Up Devices. Readers of this Guidance Note may also wish to consult the Panel’s Guidance Note on Lock Up Devices.

² Except where otherwise specified, legislative references are to the *Corporations Act 2001* and references to companies include listed managed investment schemes.

³ See section 652C.

⁴ See section 652B and Practice Note 59.

(iii) the voting interests in a listed managed investment scheme; takes place in an efficient, competitive and informed market”;

and

“as far as practicable, holders of the relevant class of shares ... 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 ...”.

7. Section 657A(3) requires the Panel, when considering the purposes set out in section 602 (c) in relation to the acquisition of a substantial interest in a company, to:

“take into account the actions of directors of the company ... (including actions that caused the acquisition or proposed acquisition not to proceed, or contributed to it not proceeding).”

Support from law and ASX Listing Rules

8. The Corporations Act and the ASX Listing Rules require shareholder approval for certain transactions that affect control, or transactions with related parties or associates of the company and its directors. The existence of these analogous constraints supports the Panel’s approach and provides some guidance when considering the sorts of actions which may give rise to unacceptable circumstances.
9. In particular, ASX Listing Rules require shareholder approval when the following significant changes are proposed to a listed company:
- (a) the acquisition or disposal of a substantial asset to a person in a position of influence (Rule 10.1);
 - (b) a change in the main undertaking of the company (Rule 11.2);
 - (c) disposal of a major asset to a company intending to list on ASX (Rule 11.4);
 - (d) when changes are made to the company’s capital structure by the issue of more than 15% of capital currently on issue (Rule 7.1);
 - (e) the issue of shares if 50% of shareholders call a meeting to remove the company’s directors (Rule 7.6); and
 - (f) the issue of shares within three months of written notice of a takeover proposal (Rule 7.9).

Bidder's right to define conditions

10. The Corporations Act allows a bidder to make a takeover offer subject to defeating conditions, with specified exceptions.⁵ Often a bidder includes conditions in order to protect itself from having to proceed if, for example:
 - (a) it receives less than a specified minimum level of acceptances;
 - (b) it does not receive relevant statutory approvals; or
 - (c) there are material changes to the capital structure, assets or business of the target or to key financial or economic indicators.
11. A bidder cannot rely on the breach of a condition that is itself contrary to Part 6.4 to support an argument that the target's actions give rise to unacceptable circumstances. An example might be a condition whose satisfaction is subject to a whim, or under the control, of the bidder.
12. A bidder must set out the conditions of its offer clearly⁶, or assume the risk that the Panel may not consider that triggering action of which it later complains gives rise to unacceptable circumstances.
13. The Panel does not seek to limit the bidder's freedom to impose any defeating conditions that it is otherwise free to make. However, the Panel will not regard the breach of a defeating condition which cannot commercially be considered critical to the bid as giving rise to unacceptable circumstances. See also paragraph 34 below.

Directors' Duties

14. Fiduciary duties of directors are dealt with separately under corporate law. Those duties, at common law and under the Corporations Act, require directors (amongst other things) to act in good faith and for proper purposes and in the best interests of the company as a whole. The Panel's role, however, is not to enforce the law of directors' duties – that role remains with the courts.
15. This Guidance Note looks generally to the effect of triggering action on an offer. Frustrating actions that the Panel would likely consider to constitute unacceptable circumstances may also be found separately by a Court to constitute a breach of directors' duties. In such cases, the Panel will look to the circumstances of each matter in considering whether it is appropriate for it to conduct proceedings or to allow the issues to be considered in another forum.⁷

⁵ See Division 4 of Part 6.4 of the Corporations Act.

⁶ A bidder should fully summarise all the conditions of its offer in any bid announcement. Of course, these conditions must then be fully set out in the offer.

⁷ During a bid period, section 659B provides that only ASIC may initiate court proceedings in relation to the bid. It may be that the Panel decides that issues brought before it, which cover

16. Neither the Corporations Act nor the common law expressly prohibit a target company board from taking action that may trigger the conditions of a takeover offer. In general, the law does not require a target company to obtain shareholder approval prior to entering into such a transaction. However, when a company is subject to an offer, in the circumstances envisaged by sections 602(a) and (c) and 657A(3), the Panel may prevent directors from taking triggering actions.
17. The Panel is concerned with the likely effect of triggering action on the target shareholders' ability to decide on the offer as an alternative to the board's proposal, rather than whether the target directors have complied with their duties to the target company.
18. In exercising its functions and powers conferred by the Corporations Act, the Panel may override directors' decisions where those decisions are likely to interfere with shareholders' opportunity to consider an offer. The Panel may do so even where the triggering action exhibits no want of good faith and is consistent with directors' duties.
19. Target directors may generally recommend rejection of a bid or seek alternatives to a bid without breaching their duties or contravening the policy of Chapter 6. They may consider that shareholders' interests are best served by seeking an offer from another bidder or formulating a competing proposal of another kind, without inhibiting the first bidder from continuing or making its offer. If they do this, they are likely to facilitate a competitive market for the control of the target consistent with the principle set out in section 602(a).
20. The Panel will be less likely to consider unacceptable circumstances exist where target directors solicit competing proposals for the target between which shareholders may choose. This is notwithstanding that such action might breach a condition of the original bidder's offer, particularly if the conditions are anti-competitive, overly restrictive or lack commercial justification (see also paragraph 13 above). An example of an unreasonable bid condition would be a restriction on target directors seeking competing proposals where target directors have not agreed to a no-talk agreement.

both unacceptable circumstances and directors' duties, require determination during the bid, in which case it would act. Alternatively, it might consider that the issues, although potentially unacceptable, could reasonably wait until the bid concluded and then be better dealt with by the courts as a directors' duties issue. In the latter case the Panel might decline to commence proceedings. Alternatively, in some unusual cases, the Panel might encourage ASIC to initiate, or facilitate, court proceedings in relation to the directors' duties issues during the bid (although such proceedings may not conclude during the bid period).

Policy considerations

21. The Panel's role is not to enforce the rights and obligations that already exist between parties. That is for the courts. Rather, the objective of the Panel's decisions is to create new rights and obligations between parties by making orders the Panel considers appropriate, having regard to considerations of legislative and commercial policy.⁸
22. Whether unacceptable circumstances exist depends on the particular facts of each case. The Panel will only declare that triggering action has given rise to unacceptable circumstances in appropriate cases that meet the criteria set out in sections 602 and 657A(3).
23. In determining whether particular triggering action leads to unacceptable circumstances, the Panel will consider the defeating conditions (or preconditions) of the offer in the light of any clearly stated objectives of the bidder in relation to the target.
24. The circumstances surrounding an offer and any triggering action will affect whether the action frustrates the offer and gives rise to unacceptable circumstances. For example, action that frustrated an offer that demonstrably had very little chance of proceeding or succeeding would be less likely to constitute unacceptable circumstances. This would particularly be so where the target board was able to demonstrate that the triggering action clearly represented significant value for the target.
25. The following factors may also be relevant (but are not an exhaustive list of relevant issues for any particular matter):
 - (a) the period for which the offer has been open⁹;
 - (b) whether, having regard to the level and rate of acceptances and all other relevant circumstances, it is reasonable to conclude that target shareholders have rejected the takeover bid;
 - (c) the status of bid conditions;
 - (d) whether the bidder can waive those conditions;
 - (e) whether there is a competing bid; and

⁸ See the decision of the High Court in *Precision Data Holdings Ltd v Wills* (1992) 173 CLR 167.

⁹ Triggering action that is undertaken several weeks into a bid where the bid has received few acceptances would be less at risk of a declaration of unacceptable circumstances than action taken before target shareholders had adequate time to consider the takeover bid. However, the Panel will take into account market experience that shareholders are often likely to wait until the end of the bid period before deciding whether or not to accept an offer.

(f) whether the market is trading above the bid price.

26. During the initial offer period, the offer is new to the target shareholders and they are still assessing the merits of the bid. Therefore, over this period it will be more difficult for a target board to demonstrate to the Panel that triggering action should be allowed to frustrate the offer.

Examples of unacceptable circumstances

27. Examples of target actions which might give rise to unacceptable circumstances include:

- (a) issuing new shares or repurchasing shares, if significant in the context of the target's issued capital and the structure of the bid;
- (b) issuing securities convertible into a significant number of bid class securities or options over a significant number of bid class securities¹⁰;
- (c) acquiring or disposing of a major asset, including making a takeover bid;
- (d) undertaking significant liabilities (e.g. committing to invest substantial funds for a major undertaking);
- (e) declaring a special or abnormally large dividend; and
- (f) significantly changing company share plans.

Action that may not give rise to unacceptable circumstances

28. In general, a target will not give rise to unacceptable circumstances by undertaking triggering action that is part of the ordinary course of its business or by carrying out agreements which were entered into or announced before the bid was made known to the company, so long as these agreements are not otherwise found to create unacceptable circumstances¹¹. In these respects, a bidder must accept that the target's

¹⁰ Issuing a small number of securities may be significant if this would prevent a bidder from attaining a commercial benefit it might otherwise reasonably expect, for example, the ability to group the target for tax purposes if the bidder were otherwise able to acquire 100% of the target's securities under the bid.

¹¹ Agreements which the Panel considers are 'poison pills' and have not been approved by relevant shareholders may be found to create unacceptable circumstances. See paragraph 35.

normal business will continue, and therefore the target will continue to change to a certain degree.

29. It may be that transactions which materially alter the target's business, or a particular unit of the business, form part of the target company's business plan and might be considered part of the target's ordinary course of business. In determining whether unacceptable circumstances exist in those situations, the Panel will balance the nature of the triggering action against its potential effect on the bidder's stated objectives in relation to the target.
30. If a target board wants the Panel to accept that transactions, either announced or entered into after a bid has been announced, are part of the target's normal business, it will need to demonstrate this to the Panel. The more material the size or nature of the transaction, the higher will be the onus on the target board to show that it comes within the ordinary course of the target's business or is not properly the concern of the bidder.
31. Triggering action will not normally give rise to unacceptable circumstances, if it is taken by a target merely to comply with a court order, legislative requirement or Government directive.
32. In addition, triggering action will not normally give rise to unacceptable circumstances if there is a commercial or legal imperative for the target to take that action other than as a result of some voluntary action taken by the target directors after they become aware of an offer or a potential offer. The target may be seeking to avoid a materially adverse financial effect or to meet an obligation which, if not performed, may result in materially adverse legal action against the target.
33. An action may lead to an offer lapsing without giving rise to unacceptable circumstances if:
 - (a) it does not materially affect the financial or business position of the company (e.g. buying back a small number of shares in the face of a condition that no share buy back be undertaken by the target); or
 - (b) the bid condition is overly extensive or restrictive.
34. In general it will not be unacceptable for a target to decline to co-operate with the bidder, for example, by failing to:
 - (a) facilitate due diligence; or
 - (b) satisfy a condition that it enter into a material transaction which is not part of its ordinary course of its business or contemplated by its business plan.

This is not to suggest that it is inappropriate for a bidder to announce a bid subject to such conditions.

35. This Guidance Note does not consider pre-emptive action which directors take in the absence of an offer but which is designed to protect against a possible future change of control (sometimes known as a “poison-pill”). The Panel may issue a guidance note on this issue in the future, if it appears necessary.

A Better Deal?

36. A target company’s directors may consider that a proposed course of action is clearly in the target’s interests, because it is likely to provide materially greater value for the target compared to the offer. They may consider that it is preferable even though it may trigger a defeating condition of an offer. In such a case, it may, on balance, be consistent with the policy of Chapter 6 for directors to attempt to secure that value for the company.

37. Nonetheless, decisions about control and ownership of a company should properly be the preserve of the shareholders. Accordingly, directors of a target should proceed with caution when considering action that has the potential to frustrate an offer. This may involve obtaining independent legal and financial advice.

38. Target directors may avoid the possibility that any triggering action they propose could give rise to unacceptable circumstances in a number of ways that balance the objectives of Chapter 6 with the directors’ obligations to the company. In particular cases, these may include:

- (a) directors announcing that they will enter into an agreement after a specified, reasonable time, unless control has by then passed to the bidder;
- (b) seeking prior shareholder approval;
- (c) making triggering action conditional on obtaining shareholder approval; or
- (d) entering into an agreement which is subject to a condition that the bid fails or which contains a cooling-off clause which a new management might exercise.

39. Where practicable, these approaches would allow shareholders to make a choice between the offer and the triggering action proposed by the target. This gives effect to the principle that shareholders have reasonable and equal opportunities to participate in any benefits accruing under an offer.

Time constraints

40. In some limited circumstances a transaction may be lost because of the length of time involved in calling a general meeting. For example, an opportunity may present itself to the target board which it considers it is likely to be in the company's best interests to pursue, but which may only have a short window for acceptance or completion.
41. Generally, the Panel will not consider a threat to withdraw by the counterparty to the proposed transaction to be sufficient to prevent the triggering action giving rise to unacceptable circumstances. The Panel will require the target to present evidence as to:
- (a) the value lost or cost to the target of losing the transaction;
 - (b) the reasons that the transaction must be completed before a general meeting could be convened to consider the transaction; and
 - (c) the reasons why the transaction cannot be conditional on shareholder approval or, alternatively, on the offer failing.

Preventative steps a bidder and target may take

42. A bidder that is in private discussions with a target regarding a possible offer should make clear to the target what conditions would apply if such an offer were to be announced. Simply being in talks will not be sufficient for a bidder to demonstrate the existence of a genuine potential offer. This will be important if there is a later application to the Panel where the bidder may need to demonstrate that the target was aware of certain conditions that are in issue.
43. The announcement of an intention to make an offer normally includes a summary of the significant conditions that will apply to the offer when it is made. A bidder should be mindful of this Guidance Note when formulating such a summary (see paragraphs 12 and 13 of this Guidance Note).
44. The Panel expects that if an application is made to it alleging that unacceptable circumstances have arisen because an offer has been or will be frustrated by triggering action, directors will be able to provide evidence of the process and reasons for its decision to take that action.

Extending the bid to allow offerees the choice

45. If a target proposes action that the bidder considers, or is likely to consider, to be frustrating, the target may offer to seek its shareholders' decision on the proposed action. This would allow shareholders to decide,

with adequate information and time, between the two competing proposals. However, it is unlikely that the target could hold a shareholder meeting within the one month period for which most bids are initially open.

46. The Panel would be less likely to make a declaration of unacceptable circumstances against a target company where the target had offered to seek shareholder approval expeditiously and the bidder had declined to extend its bid to a date reasonably required by the target to hold the meeting. Similarly, the Panel would be more likely to make a declaration of unacceptable circumstances where a bidder had offered to extend its bid in such a manner and the target company did not seek shareholder approval.
47. The Panel's decision in such circumstances will depend on the particular circumstances of the individual matter. The Panel will consider issues such as: what is a reasonable period of time for the target to prepare the notice of meeting, how long has the target been considering the proposed action, and what are the benefits to target shareholders of the proposed action.

If shareholders consider triggering action

48. If shareholders approve triggering action in general meeting that may otherwise have frustrated an offer, the bidder will normally have the choice of allowing its offer to lapse or waiving the condition. If it is too late to waive the condition, or if it is unwaivable, the offer will close with the condition unfulfilled.
49. If the target puts a resolution to its shareholders to approve triggering action and the resolution fails, the Panel will usually require a bidder who has made an application in relation to that action, to agree not to rely on the fact that the action was proposed or submitted to the general meeting as triggering a defeating condition of its offer. This may require the bidder to take action to ensure that the relevant condition is not invoked and that the offer is not affected by the condition technically having been triggered, for instance by varying or waiving the condition.

Remedies

50. The Panel has wide powers to make orders under section 657D if it finds that triggering action by target directors gives rise to unacceptable circumstances. This includes preventing an action or transaction from proceeding or requiring the target to seek shareholders' approval of the action or transaction in general meeting. It also includes unravelling an action or transaction that has already occurred.
51. The Panel's remedies will be aimed at ensuring that:

- a. target shareholders are given a reasonable opportunity to consider the merits of competing proposals which may affect control and deciding between them; and
 - b. ensuring a takeover proceeds, as far as possible, in a way that it would have done if the unacceptable circumstances had not occurred.
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